

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name City of Hillsdale	County Hillsdale
Fiscal Year End June 30, 2006	Opinion Date August 31, 2006	Date Audit Report Submitted to State December 20, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

YES NO **Check each applicable box below.** (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Willis & Jurasek, P.C.		Telephone Number (517) 788-8660	
Street Address 2545 Spring Arbor Road, Suite 200		City Jackson	State MI
Zip 49203			
Authorizing CPA Signature F. Roger Mack	Printed Name F. Roger Mack	License Number 1101020342	

City of Hillsdale, Michigan

Financial Statements
And Independent Auditors' Report

Year Ended June 30, 2006

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Independent Auditors' Report

The Honorable Mayor and
Members of the City Council
City of Hillsdale, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Hillsdale, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Hillsdale, Michigan, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 31, 2006, on our consideration of the City's internal control over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information, as listed in the table of contents, are not a required part of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

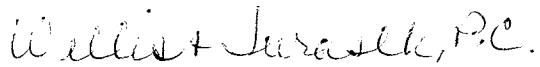
WILLIS & JURASEK, P.C.

2545 Spring Arbor Road
Post Office Box 39
Jackson, Michigan 49204-0039

The Honorable Mayor and
Members of the City Council

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Hillsdale's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.

Sincerely,

A handwritten signature in cursive script that reads "Willis & Jurasek, P.C.".

Willis & Jurasek, P.C.

August 31, 2006



**Report on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Honorable Mayor and
Members of the City Council
City of Hillsdale, Michigan

We have audited the basic financial statements of the City of Hillsdale, Michigan as of and for the year ended June 30, 2006, and have issued our report thereon dated August 31, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City Of Hillsdale's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the City of Hillsdale's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management, the City Council, others within the organization, State agencies, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Willis & Jurasek, P.C.
Willis & Jurasek, P.C.

August 31, 2006

WILLIS & JURASEK, P.C.

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Management's Discussion and Analysis

As management of the *City of Hillsdale, Michigan*, we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006.

Financial Highlights

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$50,158,406 (*net assets*). Of this amount, \$10,935,255 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The government's total net assets increased by \$753,884.
- As of the close of the current fiscal year, the City's Governmental funds reported combined ending fund balances of \$2,265,203. Approximately seventy-two percent (72%) of this total amount, or \$1,633,701, is *available for spending* at the government's discretion (*unreserved and undesignated*).
- At the end of the current fiscal year, unreserved fund balance for the general fund was \$651,092, or about twenty percent (18%) of total general fund expenditures.
- The City's total bonded debt decreased by \$385,000 during the current fiscal year. Overall long-term debt for the City decreased almost eight percent (7.8%).

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public services, parks and recreation, community development, long-term debt. The business-type activities are electric, sewer, water, and transportation.

The government-wide financial statements include not only the City itself (known as the *primary government*), but also two legally separate authorities – the Tax Increment Finance Authority and the Economic Development Corporation – for which the City is financially accountable. Financial information for these *component units* is reported separately from the financial information presented for the primary government itself.

The government-wide financial statements can be found on pages 1-3 of this report.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains sixteen individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general and capital improvement funds, each of which are considered to be major funds. Data from the other fourteen governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of *combining statements* elsewhere in this report.

The City adopts an annual appropriated budget for its general and special revenue funds. Budgetary comparison statements or schedules have been provided herein to demonstrate compliance with those budgets.

The basic governmental fund financial statements can be found on pages 4-7 of this report.

Proprietary funds. The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its electric, sanitary sewer, water distribution, and public transportation operations. *Internal service funds* account for operations that provide services (such as leave and benefits, inventory purchasing, equipment rental and unemployment insurance) and accumulate and allocate costs internally among the City's various functions. Because this service predominantly benefits governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for three major enterprise funds; electric, water, and sewer, and one non-major fund, Dial-A-Ride.

The basic proprietary fund financial statements can be found on pages 8-11 of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statements because the resources of those funds are *not* available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary fund financial statements can be found on pages 12-13 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 14-29 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain other information. This includes combining and individual fund financial statements and schedules, which can be found on pages 30-53 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Hillsdale, assets exceeded liabilities by \$50,158,406 at the close of the most recent fiscal year.

By far the largest portion of the City's net assets, about seventy-two percent (72%), reflects its investment in capital assets (e.g., land, buildings, vehicles, equipment and infrastructure) less any outstanding related debt used to acquire those assets. The City uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

City's Net Assets	Governmental		Business-type		Total		Total
	Activities		Activities				Percent
	2005	2006	2005	2006	2005	2006	Change
Current and Other Assets	\$3,606,439	\$3,130,986	\$11,577,169	\$12,674,115	\$15,183,608	\$15,805,101	4.09%
Capital Assets	\$19,398,343	\$19,420,188	\$22,391,194	\$21,964,023	\$41,789,537	\$41,384,211	-0.97%
Total Assets	\$23,004,782	\$22,551,174	\$33,968,363	\$34,638,138	\$56,973,145	\$57,189,312	0.38%
Long-term Liabilities Outstanding	\$1,239,112	\$1,107,203	\$4,946,017	\$4,177,610	\$6,185,129	\$5,284,813	14.56%
Other Liabilities	\$353,866	\$328,153	\$1,029,628	\$1,417,941	\$1,383,494	\$1,746,094	26.21%
Total Liabilities	\$1,592,978	\$1,435,356	\$5,975,645	\$5,595,551	\$7,568,623	\$7,030,907	-7.10%
Net Assets:							
Invested In Capital Assets Net of Related Debt	\$18,199,343	\$18,369,188	\$17,591,194	\$18,106,938	\$35,790,537	\$36,476,126	1.92%
Restricted	\$1,913,726	\$1,521,164	\$1,201,315	\$1,225,861	\$3,115,041	\$2,747,025	11.81%
Unrestricted	\$1,298,735	\$1,225,467	\$9,200,209	\$9,709,788	\$10,498,944	\$10,935,255	4.16%
Total Net Assets	\$21,411,804	\$21,115,819	\$27,992,718	\$29,042,587	\$49,404,522	\$50,158,406	1.53%

An additional portion of the City's net assets (\$2,747,025) represents resources that are subject to external restrictions on how they may be used. The remaining balance of *unrestricted net assets*, \$10,935,255, may be used to meet the government's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

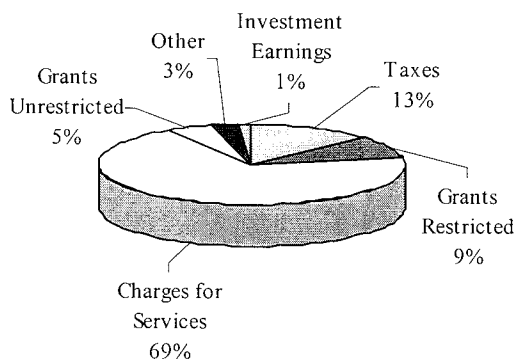
During the current fiscal year the total government's net assets increased by \$753,884. The increase reflects the degree to which ongoing revenues exceed ongoing expenses in both the business-type and governmental activities. Net assets decreased in the governmental activities by \$295,985 and increased by \$1,049,869 in the business-type activities.

City's Changes in Net Assets

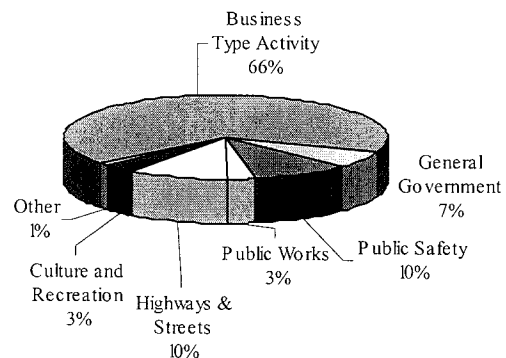
	Governmental		Business-type		Total		Total
	Activities		Activities		Total		Percentage
	2005	2006	2005	2006	2005	2006	Change
Revenues:							
Program Revenues:							
Charges for Services	\$375,709	\$375,192	\$12,169,073	\$12,221,765	\$12,544,782	\$12,596,957	0.42%
Operating Grants & Contributions	1,251,298	1,211,946	205,526	312,951	\$1,456,824	\$1,524,897	4.67%
Capital Grants & Contributions	91,926	89,763	0	0	\$91,926	\$89,763	-2.35%
Total Revenues	\$1,718,933	\$1,676,901	\$12,374,599	\$12,534,716	\$14,093,532	\$14,211,617	0.84%
Expenses:							
General Government	1,045,363	1,175,151			\$1,045,363	\$1,175,151	12.42%
Public Safety	1,628,454	1,690,177			\$1,628,454	\$1,690,177	3.79%
Public Services	486,060	527,574			\$486,060	\$527,574	8.54%
Highways & Streets	1,603,315	1,719,973			\$1,603,315	\$1,719,973	7.28%
Health (Building Inspect/Assessing)	160,836	153,560			\$160,836	\$153,560	-4.52%
Recreation & Culture	543,792	586,329			\$543,792	\$586,329	7.82%
Interest on Long-term Debt	23,586	20,897			\$23,586	\$20,897	-11.40%
Other	61,195	17,963			\$61,195	\$17,963	61195%
Unallocated Depreciation	43,019	36,368			\$43,019	\$36,368	-15.46%
Electric			9,092,388	9,241,618	\$9,092,388	\$9,241,618	1.64%
Water			955,433	1,024,046	\$955,433	\$1,024,046	7.18%
Sewer			1,062,007	976,308	\$1,062,007	\$976,308	-8.07%
Transportation			447,737	429,267	\$447,737	\$429,267	-4.13%
Total Expenses	\$5,595,620	\$5,927,992	\$11,557,565	\$11,671,239	\$17,153,185	\$17,599,231	2.60%
Increase (Decrease) in							
Net assets Before Transfers	(\$3,876,687)	(\$4,251,091)	\$817,034	\$863,477	(\$3,059,653)	(\$3,387,614)	10.72%
General Revenues:							
Taxes	2,569,077	2,464,617			\$2,569,077	\$2,464,617	-4.07%
Grants & Contributions Not Restricted							
To Specific Programs	943,008	931,294			\$943,008	\$931,294	-1.24%
Unrestricted Investment Earnings	88,179	106,929	145,285	137,562	\$233,464	\$244,491	4.72%
Other Revenues	420,419	508,362	55,631	(9,120)	\$476,050	\$499,242	4.87%
Prior Year Adjustment CDBG					\$0	\$0	
Loss on sale of Land					\$0	\$0	
Transfers - Internal Activity	(168,003)	(56,897)	113,093	57,950	(\$10,167)	\$1,853	-118.23%
Total General Revenues	3,897,423	3,955,105	314,009	186,392	4,211,432	4,141,497	-1.66%
Net Income	\$20,736	(\$295,986)	\$1,131,043	\$1,049,869	\$1,151,779	\$753,883	-34.55%
Net Assets - Beginning of Year	\$21,391,068	\$21,411,805	\$26,861,675	\$27,992,718	\$48,252,743	\$49,404,523	2.39%
Net Assets - End of Year	\$21,411,804	\$21,115,819	\$27,992,718	\$29,042,587	\$49,404,522	\$50,158,406	1.53%

The City's total revenue, including special items, was \$18,353,114. This represents an increase of about one quarter of one percent (0.27%) over last year. The biggest share of this revenue, sixty-nine percent (69%), comes from charges for services. Ninety-seven percent (97%) of that is from business-type activities. Approximately thirteen percent (13%) of all revenue comes from taxes. Another fourteen percent (14%) is from federal, state, and local grant sources. All other revenues combined amount to only four percent (4%) of total revenues. Only six percent (6%) of the governmental activities revenue comes from charges for services as apposed to ninety-six (96%) for business-type activities (Board of Public Utilities and Dial-A-Ride).

**Source of Revenue for Fiscal Yr 2006
Governmental & Business-type Activities**



**Functional Expenses for Fiscal Yr 2006
Governmental & Business-type Activities**



On the expense side, the largest portion of the expenditures, sixty-six percent (66%) is for the business type activities (Board of Public Utilities and Dial-A-Ride). General government amounts to only seven percent (7%) of total costs of both business and governmental activities; public safety and streets and highways are both at ten percent (10%) each, and recreation and culture and public works are both at three percent (3%) each.

Governmental activities. Governmental activities had a net income loss of \$295,986. Key elements of this decrease are as follows:

- Property taxes decreased \$104,460 (4%) during the year. Last year we collected about \$81,000 in industrial facilities tax abatement claw-backs from two manufacturing firms in town that had received industrial facilities tax credits. By closing their plants they breached the terms for their tax abatement contracts. The portion of the tax credit they used was billed back to these companies (claw-backs) resulting in a one time windfall of tax revenues last year.
- Payments in Lieu of Taxes (PILOT) revenue was up six percent (6%) over last year. These are payments made to the local government in place of property taxes. The City receives a PILOT from the Board of Public Utilities, Greenwood Village, Hillside Place, and Hilltop Apartments.
- State Revenue Sharing declined for the fifth consecutive year.

- Governmental activities investment earnings were up for the second consecutive year. Even with a volatile investment climate, earnings have continued to improve. They were up over fifty-five percent (55%) from last year.
- Governmental activities operational costs have increased by \$332,372, which is more than six percent (6%) over the prior year. These increases are driven by increases in health insurance premiums and rising employer retirement contributions.
- More than \$1 Million was invested in capital expenditures during the year. The City put \$765,784 into major and local street reconstruction and resurfacing projects; another \$125,617 on sidewalk construction and replacement; spent \$33,000 on the M-99 highway reconstruction; and purchased a housing development (Three Meadows) for \$180,000.

Business-type activities. Business-type activities increased the City's net assets by \$1,049,869, accounting for all of the growth in the government's net assets for the current year. Key elements of this increase are as follows:

- This year the electric funds net income was \$729,356. Although the income dropped almost twenty-four percent (23.8%) from one year ago its net income accounts for sixty-nine percent (69%) of the total business-type activities net income and ninety-six (96%) of the total net income for the governmental and business-type activities combined. The decline in net income can be traced to increased operating expenses due to the costs for purchased power going up \$275,516 and the cost of transmission and distribution of that power, which went up \$16,163. Administrative and production expenses in this fund were both down from the previous year by eleven percent (11%) and two percent (2%) respectively, but were not enough to offset the increases.
- The water fund experienced a net income of \$99,283, which amounts to about a forty-five (45%) decrease from last year. Operating revenues in this fund were about the same as the prior year. The difference again is in the production and distribution expenses that went up by twenty-five (25%).
- The sewer fund net income was up two hundred and thirty percent (230%). The Board of Public Utilities removed an incorrect book value for an inter-departmental loan to the City in 2005 resulting in a fifty-one percent (51%) reduction in net income last year. This, in connection with a net reduction of \$82,200 in sewer operational expense, has resulted in this phenomenal increase.
- The transportation fund finished the year with a net gain of \$637. Dial-A-Ride ridership has continued to increase, as is evidenced by an eighteen percent (18%) increased in charges of services over last fiscal year.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$2,265,203. That is a decrease of \$430,441 in comparison with the prior year. Of that number, \$1,633,701 is designated as unreserved. Overall, the total governmental fund revenues decreased by just over one percent (1.33%) or \$76,900 and the total expenditures increased by \$1,186,568 or twenty-four percent (24%) from last year. The revenue decrease is primarily due to a reduction in intergovernmental - federal and State revenues, and decreased tax revenues caused from last years industrial facilities tax abatement claw-backs. The increase in expenditures is the result of extensive major street and highway reconstruction/resurfacing work done that increased capital outlay by two hundred sixty-six percent (266%) in comparison with last year when no major construction projects were done. The *reserved* fund balance (\$631,502) of the governmental funds is not available for new spending because it has already been committed 1) to generate income for the support and maintenance of R.L. Owen's Park (\$14,018); 2) to generate income to pay for the perpetual care of the two municipal cemeteries (\$544,084); and 3) \$73,400 is reserved to pay expenditures already incurred for the 2006-07 fiscal year.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, the total fund balance of the general fund was \$722,663. All of this balance except for \$71,571 is unreserved and therefore available for spending at the government's discretion.

During the current fiscal year, the fund balance of the City's general fund increased by \$77,387. This is primarily attributable a reduction in transfers out to other funds.

The *Capital Improvement Fund* ended the year with a fund balance of \$469,190, which is a forty-four percent (44%) reduction over the prior year. This was a planned reduction, as the City had made preparation over the past two years for the extensive major street and highway construction projects undertaken this year.

Other nonmajor governmental funds collectively experienced a decrease in fund balances for the year of \$131,764. Revenues and expenditures for these funds were relatively the same as last fiscal year. Other financing sources in these funds decreased substantially (77%) from the prior year. This decrease is the result of street and highway projects, as well as capital improvements done in the cemeteries and parks. Additional transfers done this year were: \$100,000 from major street fund to local street fund for street resurfacing projects; an additional \$37,500 from general fund went to the local street fund for general maintenance; R.L. Owens memorial fund transferred \$12,000 to the capital improvement fund for electrical upgrades and the construction of a dock platform in Owens Park; and the cemetery perpetual care fund transferred an additional \$8,871 to the capital improvement fund for the construction of a new storage building at Oak Grove Cemetery.

Proprietary funds. The City's proprietary funds provide the same type of information found in the government wide financial statements, but in more detail.

Unrestricted net assets of the water, sewer, electric, and transportation funds at the end of the year amounted to a total of \$9,709,788. Net income for all City proprietary funds was \$1,049,869. All the business-type funds showed a net income for the year.

General Fund Budgetary Highlights

Differences between original and final amended revenue budget for general fund totaled \$315,000. During the budget process several revenue items were underestimated. Current taxes were estimated low by \$100,000; interest returns were increased \$50,000; and state revenue sharing fared better than expected, so it was raised \$40,000; and contributions in lieu of taxes was also increased \$25,000 to better reflect what would actually be collected. The Board of Public Utilities offered a grant to fund a new economic development department, so the budget was amended by \$100,000 to reflect this change.

Differences between the original and final amended expenditure budgets for general fund totaled \$335,000. The increases for an additional retirement contribution above and beyond what was required were as follows: the clerk's went up budget \$2,200, city manager's budget went up \$5,400; the assistant city manager's budget went up \$2,200; the finance department added \$2,200; the police department went up \$40,000; the fire department rose by \$40,000; public services department added \$4,400; and the assessor increased \$2,800. A new budget was created for an economic development director of \$100,000. The treasurer's budget was increased \$90,800 to accommodate a Michigan tax tribunal settlement with Aquila. An additional \$10,000 was added to the airport budget to pay for increased insurance costs and lighting repairs not originally budgeted. The culture and recreation – parks budget was increased by \$35,000 to pay for additional costs associated with play equipment repair, picnic table construction, and dock space reorganization.

Transfers out of general fund were increased by \$300,000. The capital improvement fund transfer budget was increased by \$300,000 to fund infrastructure improvements in current and subsequent years.

The City originally budgeted for a balanced budget. The amended budget depicted a final fund balance of \$325,276. As the revenues did not do as well as anticipated, the additional transfers to the retirement system and capital improvement fund were not made. The original transfer budgets for local street and Dial-A-Ride were not all needed but an amendment was not done to reflect these reductions. The actual year end fund balance for the general fund was \$722,663, which was an increase of \$77,387 over the prior year.

Budget to actual comparisons for all other City special revenue funds were favorable in varying degrees.

Capital Asset and Debt Administration

Capital assets. The City's investment in capital assets for its governmental and business type activities as of June 30, 2006, amounted to \$36,476,126 (net of related debt). This investment in capital assets includes land, buildings and system improvements, machinery and equipment, Library books, recreational land improvements, roads, sidewalks, and storm water utility. The City's total capital assets increased in the current fiscal year about one percent (1%) for governmental activities and about three percent (3%) for business-type activities.

Major capital asset events during the current fiscal year included the following:

- A variety of infrastructure projects (street resurfacings/ reconstructions and sidewalk construction) were done throughout the year at a combined cost of approximately \$924,131.
- The utility (electric, water, and sewer funds) did a variety of projects throughout the year totaling \$900,094. Those projects included the completion of the tank work at the Power Plant; overhead extensions; URD extensions and conversions; back-up generators; various transformers and meters; cleaning of well #2 & #8; water valve replacements; hydrant replacements; water main upgrades; and the purchase of various pieces of equipment.
- Primary government purchased one police patrol car, a mower for the airport, and a five-yard dump truck for a total cost of \$124,989.
- The library purchased numerous books at a total cost of \$19,770.
- Buildings and improvements of \$28,315 were done. A new storage building was constructed in Oak Grove Cemetery and a three-sided clock was installed in the Library building tower.
- Land improvements consisted to renovations to Mrs. Stocks Park, construction of a dock platform and pavilion repairs and upgrades in Owens Park in the amount of \$35,464.

	City's Capital Assets (Net of Depreciation)						Total Percent Change 2004-05
	Governmental		Business-type				
	Activities		Activities		Total		
	2005	2006	2005	2006	2005	2006	
Land	\$3,271,793	\$3,451,793	\$17,467	\$189,982	\$3,289,260	\$3,641,775	-10.72%
Buildings and System Improvements	3,863,215	3,825,977	21,725,200	21,840,812	25,588,415	\$25,666,789	-0.31%
Library Books	44,452	53,880			44,452	\$53,880	-21.21%
Machinery and Equipment	865,268	846,664	416,261	123,211	1,281,529	\$969,875	24.32%
Infrastructure	11,353,615	11,241,874			11,353,615	\$11,241,874	0.98%
Construction in Progress	0	0	232,266	367,933	232,266	367,933	-58.41%
Total	\$19,398,343	\$19,420,188	\$22,391,194	\$22,521,938	\$41,789,537	\$41,942,126	-0.37%

Additional information on the City’s capital assets can be found in note No. 5 on pages 22 -23 of this report.

Long-term debt. At the end of the current fiscal year, the City had total bonded debt outstanding of \$4,415,000, which consisted of revenue bonds, where the City has pledged the income to be received from the constructed assets to pay the debt service of the related bond issues. The City has no general obligation bonds outstanding.

City's Outstanding Debt				
Revenue Bonds				
	Business-type Activities		Total	
	2005	2006	2005	2006
Revenue Bonds	\$4,800,000	\$4,415,000	\$4,800,000	\$4,415,000
Total	\$4,800,000	\$4,415,000	\$4,800,000	\$4,415,000

The City’s total debt decreased during the current fiscal year by \$489,797 or about eight percent (7.8%). No new debt was issued during the year.

The City of Hillsdale has a revenue bond rating with Standard & Poor’s of “BBB” and a “Baa1” rating from Moody’s.

State statutes limit the amount of general obligation debt a governmental entity may issue to 10 percent of its total assessed valuation. The current debt limitation for the City is \$17,842,369, which is significantly in excess of the City’s total outstanding long-term debt obligation of \$5,866,332.

Additional information on the City’s long-term debt can be found in note No. 8 on pages 26-28 of this report.

Economic Factors and Next Year’s Budgets and Rates

The following factors were considered in preparing the City’s budget for the 2006-07 fiscal year:

- The unemployment rate for Hillsdale County (which includes the City) in April of 2006, when the budget was prepared, was 7.2%. That was an increase of 0.8% from a year ago and 0.4% higher than the State of Michigan’s unemployment rate for the same period.
- Inflationary trends in the region compare favorably to national indices.
- State shared revenues are likely to decrease due to declining revenue streams coming in to the State of Michigan, for which a portion are distributed back to municipalities based on formulas.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Department, 97 N. Broad Street, Hillsdale, Michigan 49242.

City of Hillsdale, Michigan
Statement of Net Assets
June 30, 2006

	Primary Government			Component Units	
	Governmental	Business-type	Total	Tax Increment	Economic
	Activities	Activities		Finance Authority	Development Corporation
Assets:					
Cash and investments	\$ 2,125,847	\$ 5,668,308	\$ 7,794,155	\$ 214,925	\$ 102,127
Receivables	676,477	1,202,689	1,879,166	-	-
Internal balances	82,397	(82,397)	-	-	-
Prepaid items and other assets	103,676	139,424	243,100	-	-
Inventory	142,589	724,461	867,050	-	-
Investment in M.S.C.P.A.	-	4,463,715	4,463,715	-	-
Capital assets, net					
Assets not being depreciated	3,451,793	557,915	4,009,708	-	-
Assets being depreciated	<u>15,968,395</u>	<u>21,964,023</u>	<u>37,932,418</u>	-	-
Total assets	<u>22,551,174</u>	<u>34,638,138</u>	<u>57,189,312</u>	<u>214,925</u>	<u>102,127</u>
Liabilities:					
Accounts payable	103,717	95,100	198,817	-	-
Accrued expenses	39,108	881,896	921,004	-	-
Accrued interest	3,177	41,576	44,753	-	-
Noncurrent liabilities:					
Due within one year	182,150	399,369	581,519	-	-
Due in more than one year	<u>1,107,203</u>	<u>4,177,610</u>	<u>5,284,813</u>	-	-
Total liabilities	<u>1,435,355</u>	<u>5,595,551</u>	<u>7,030,906</u>	-	-
Net Assets:					
Invested in capital assets, net of related debt	18,369,188	18,106,938	36,476,126	-	-
Restricted for:					
Debt service	2,555	1,225,861	1,228,416	-	-
Capital projects	960,507	-	960,507	-	-
Endowment and trust principal	558,102	-	558,102	-	-
Unrestricted	<u>1,225,467</u>	<u>9,709,788</u>	<u>10,935,255</u>	<u>214,925</u>	<u>102,127</u>
Total net assets	<u>\$ 21,115,819</u>	<u>\$ 29,042,587</u>	<u>\$ 50,158,406</u>	<u>\$ 214,925</u>	<u>\$ 102,127</u>

See Notes to Financial Statements.

City of Hillsdale, Michigan
Statement of Activities
Year Ended June 30, 2006

<u>Functions/Programs</u>	<u>Program Revenues</u>				<u>Net (Expense) Revenue</u>
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
Primary Government					
Governmental activities:					
General government	\$ 1,175,151	\$ 129,933	\$ 430,428	\$ 89,763	\$ (525,027)
Public safety	1,690,177	-	23,950	-	(1,666,227)
Public works	527,574	113,311	-	-	(414,263)
Highways and streets	1,719,973	-	638,595	-	(1,081,378)
Health	153,560	-	-	-	(153,560)
Culture and recreation	586,329	131,948	118,973	-	(335,408)
Interest on long-term debt	20,897	-	-	-	(20,897)
Other	17,963	-	-	-	(17,963)
Unallocated depreciation	<u>36,368</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(36,368)</u>
Total governmental activities	<u>5,927,992</u>	<u>375,192</u>	<u>1,211,946</u>	<u>89,763</u>	<u>(4,251,091)</u>
Business-type activities:					
Electric	9,241,618	9,896,409	-	-	654,791
Sewer	976,308	1,151,835	-	-	175,527
Water	1,024,046	1,114,518	-	-	90,472
Transportation	<u>429,267</u>	<u>59,003</u>	<u>312,951</u>	<u>-</u>	<u>(57,313)</u>
Total business-type activities	<u>11,671,239</u>	<u>12,221,765</u>	<u>312,951</u>	<u>-</u>	<u>863,477</u>
Total primary government	<u>\$ 17,599,231</u>	<u>\$ 12,596,957</u>	<u>\$ 1,524,897</u>	<u>\$ 89,763</u>	<u>\$ (3,387,614)</u>
Component Units					
Tax Increment Finance Authority	\$ 2,823	\$ -	\$ -	\$ -	\$ (2,823)
Economic Development Corporation	<u>615</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(615)</u>
Total component units	<u>\$ 3,438</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (3,438)</u>

continued..

City of Hillsdale, Michigan
Statement of Activities (Continued)
Year Ended June 30, 2006

	Primary Government			Component Units	
	Governmental	Business-type	Total	Tax Increment	Economic
	Activities	Activities		Finance Authority	Development Corporation
Changes in Net Assets					
Net (expense) revenue	\$ (4,251,091)	\$ 863,477	\$ (3,387,614)	\$ (2,823)	\$ (615)
General revenues:					
Property taxes	2,464,617	-	2,464,617	95,853	-
Unrestricted grants and contributions	931,294	-	931,294	-	-
Interest and investment earnings	106,929	137,562	244,491	7,457	3,552
Other revenues	508,362	(9,120)	499,242	-	-
Transfers - internal activities	(56,097)	57,950	1,853	(1,853)	-
Total general revenues, contributions and transfers	3,955,105	186,392	4,141,497	101,457	3,552
Changes in Net Assets	(295,986)	1,049,869	753,883	98,634	2,937
Net Assets - Beginning of Year	21,411,805	27,992,718	49,404,523	116,291	99,190
Net Assets - End of Year	\$ 21,115,819	\$ 29,042,587	\$ 50,158,406	\$ 214,925	\$ 102,127

See Notes to Financial Statements.

City of Hillsdale, Michigan

Balance Sheet
Governmental Funds
June 30, 2006

	Other Nonmajor Governmental			
	General	Capital Improvement	Funds	Total
<u>Assets</u>				
Cash	\$ 443,875	\$ 475,178	\$ 503,587	\$ 1,422,640
Short-term investments	-	-	443,628	443,628
Receivables:				
Accounts receivable	61,888	2,766	62,878	127,532
Special assessments	-	329,496	-	329,496
Due from other governmental units	124,324	-	95,125	219,449
Due from other funds	86,159	-	-	86,159
Prepaid expenditures	71,571	-	1,829	73,400
Total assets	<u>\$ 787,817</u>	<u>\$ 807,440</u>	<u>\$ 1,107,047</u>	<u>\$ 2,702,304</u>
<u>Liabilities and Fund Balances</u>				
Liabilities:				
Accounts payable	\$ 33,961	\$ 8,370	\$ 22,858	\$ 65,189
Due to other funds	-	-	3,762	3,762
Salaries payable	22,785	384	7,077	30,246
Deferred revenue	-	329,496	-	329,496
Other liabilities	8,408	-	-	8,408
Total liabilities	<u>65,154</u>	<u>338,250</u>	<u>33,697</u>	<u>437,101</u>
Fund Balances:				
Reserved:				
Reserved for prepaid expenditures	71,571	-	1,829	73,400
Reserved for perpetual care and endowment	-	-	558,102	558,102
Unreserved; undesignated	651,092	469,190	-	1,120,282
Unreserved; undesignated- reported in nonmajor:				
Special revenue funds	-	-	345,866	345,866
Debt service funds	-	-	5,732	5,732
Capital project funds	-	-	161,821	161,821
Total fund balances	<u>722,663</u>	<u>469,190</u>	<u>1,073,350</u>	<u>2,265,203</u>
Total liabilities and fund balances	<u>\$ 787,817</u>	<u>\$ 807,440</u>	<u>\$ 1,107,047</u>	<u>\$ 2,702,304</u>

See Notes to Financial Statements.

City of Hillsdale, Michigan

Reconciliation of Fund Balances on the Balance Sheet for Governmental Funds to Net Assets
of Governmental Activities on the Statement of Net Assets
June 30, 2006

Total Fund Balances - Governmental Funds \$ 2,265,203

Amounts reported for governmental activities in the Statement
of Net Assets are different because:

Capital assets used in governmental activities are not financial
resources and are not reported in the funds.

The cost of the capital assets is

\$ 36,977,457

Accumulated depreciation is

(17,557,269)

19,420,188

Because the focus of governmental funds is on short-term financing,
some assets will not be available to pay for current-period expenditures.
Those assets (such as certain receivables) are offset by deferred revenues
in the governmental funds, and these are not included in fund balance.

Deferred special assessments

329,496

Internal service funds are used by management to charge the costs of certain
equipment usage and administrative costs to individual governmental funds.
The assets and liabilities of the internal service funds are included in governmental
activities in the Statement of Net Assets.

Net assets of governmental activities accounted for in the internal service fund

347,390

Long-term liabilities not due and payable in the current period
and not reported in the funds:

Contracts and loans payable

(1,051,000)

Accrued interest

(3,177)

Compensated absences

(192,281)

Total Net Assets - Governmental Activities

\$ 21,115,819

City of Hillsdale, Michigan
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2006

	General	Capital Improvement	Other Nonmajor Governmental Funds	Total
Revenues:				
Taxes	\$ 2,346,167	\$ -	\$ 148,829	\$ 2,494,996
Intergovernmental - federal and State	941,892	-	655,264	1,597,156
Charges for services	-	-	101,380	101,380
Fines and violations	-	-	57,605	57,605
Miscellaneous	<u>1,139,884</u>	<u>122,672</u>	<u>171,083</u>	<u>1,433,639</u>
Total revenues	<u>4,427,943</u>	<u>122,672</u>	<u>1,134,161</u>	<u>5,684,776</u>
Expenditures:				
General government	1,170,072	-	-	1,170,072
Public safety	1,631,076	-	9,807	1,640,883
Public works	476,436	-	-	476,436
Highways and streets	-	-	745,399	745,399
Health	153,035	-	-	153,035
Culture and recreation	152,957	-	337,084	490,041
Debt service:				
Principal payments	-	-	148,000	148,000
Interest and fiscal charges	-	-	21,264	21,264
Capital outlay	<u>-</u>	<u>1,151,900</u>	<u>62,090</u>	<u>1,213,990</u>
Total expenditures	<u>3,583,576</u>	<u>1,151,900</u>	<u>1,323,644</u>	<u>6,059,120</u>
Revenues Over (Under) Expenditures	<u>844,367</u>	<u>(1,029,228)</u>	<u>(189,483)</u>	<u>(374,344)</u>
Other Financing Sources (Uses):				
Operating transfers in	22,000	653,164	412,360	1,087,524
Operating transfers out	<u>(788,980)</u>	<u>-</u>	<u>(354,641)</u>	<u>(1,143,621)</u>
Total other financing sources (uses)	<u>(766,980)</u>	<u>653,164</u>	<u>57,719</u>	<u>(56,097)</u>
Net Changes in Fund Balances	77,387	(376,064)	(131,764)	(430,441)
Fund Balances - Beginning of Year	<u>645,276</u>	<u>845,254</u>	<u>1,205,114</u>	<u>2,695,644</u>
Fund Balances - End of Year	<u>\$ 722,663</u>	<u>\$ 469,190</u>	<u>\$ 1,073,350</u>	<u>\$ 2,265,203</u>

See Notes to Financial Statements.

City of Hillsdale, Michigan
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances
of Governmental Funds to the Statement of Activities
Governmental Funds
Year Ended June 30, 2006

Net Change in Fund Balances - Total Governmental Funds **\$ (430,441)**

Amounts reported for governmental activities in the Statement
of Activities are different because:

Governmental funds report capital outlays as expenditures; in the
Statement of Activities, these costs are allocated over their estimated
useful lives as depreciation.

Depreciation expense	\$ (1,198,217)	
Capital outlay	<u>1,196,027</u>	(2,190)

Revenues in the Statement of Activities that do not provide current financial
resources are not reported as revenues in the funds, but rather are deferred
to the following fiscal year.

Current year deferred special assessments		(30,379)
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Bond proceeds are reported as financing sources in governmental funds
and thus contribute to the change in fund balance. In the Statement of Net
Assets, however, issuing debt increases long-term liabilities and does not
affect the Statement of Activities. Similarly, repayment of principal is an
expenditure in the governmental funds but reduces the liability in the
Statement of Net Assets.

Repayment to bond holders		148,000
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An internal service fund is used by management to charge the costs of
certain equipment usage to individual governmental funds. The net revenue
(expense) of the fund attributable to those funds is reported with
governmental activities.

Net operating income from governmental activities in the internal service fund		33,706
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Some expenses reported in the Statement of Activities do not require the use
of current financial resources and therefore are not reported as expenditures
in the funds.

Decrease in accrued interest payable on bonds		367
Increase in the accrual for compensated absences		<u>(15,049)</u>

Change in Net Assets of Governmental Activities **\$ (295,986)**

City of Hillsdale, Michigan

Statement of Net Assets

Proprietary Funds

June 30, 2006

	Business-type Activities - Enterprise Funds					Governmental Activities - Internal Service Funds
	Electric	Water	Sewer	Nonmajor Fund Dial-A-Ride	Total	
Assets:						
Current assets:						
Cash and cash equivalents	\$ 1,372,143	\$ -	\$ 370,181	\$ 68,589	\$ 1,810,913	\$ 259,579
Receivables:						
Accounts (net of allowance for bad debt of \$120,000)	1,041,101	69,506	72,313	-	1,182,920	-
Accrued interest	12,619	2,804	4,346	-	19,769	-
Due from other funds	17,506	-	1,001,735	-	1,019,241	-
Inventory, at cost	637,762	80,122	6,577	-	724,461	142,589
Prepaid expenses	81,656	20,177	32,892	4,699	139,424	30,276
Total current assets	<u>3,162,787</u>	<u>172,609</u>	<u>1,488,044</u>	<u>73,288</u>	<u>4,896,728</u>	<u>432,444</u>
Noncurrent assets:						
Restricted investments	-	633,871	591,990	-	1,225,861	-
Designated investments	2,118,218	234,959	278,357	-	2,631,534	-
Total noncurrent assets	<u>2,118,218</u>	<u>868,830</u>	<u>870,347</u>	<u>-</u>	<u>3,857,395</u>	<u>-</u>
Capital assets:						
Land	17,467	49,616	122,902	-	189,985	-
Plant and equipment	28,804,152	9,913,154	13,135,920	489,671	52,342,897	1,584,712
Construction in progress	361,654	-	6,279	-	367,933	-
	<u>29,183,273</u>	<u>9,962,770</u>	<u>13,265,101</u>	<u>489,671</u>	<u>52,900,815</u>	<u>1,584,712</u>
Less accumulated depreciation	(16,955,419)	(4,157,629)	(8,899,369)	(366,460)	(30,378,877)	(1,161,672)
Net capital assets	<u>12,227,854</u>	<u>5,805,141</u>	<u>4,365,732</u>	<u>123,211</u>	<u>22,521,938</u>	<u>423,040</u>
Other assets - investment in M.S.C.P.A.	4,463,715	-	-	-	4,463,715	-
Total assets	<u>21,972,574</u>	<u>6,846,580</u>	<u>6,724,123</u>	<u>196,499</u>	<u>35,739,776</u>	<u>855,484</u>
Liabilities:						
Current liabilities (payable from current assets):						
Accounts payable	63,964	9,825	18,519	2,792	95,100	38,528
Accrued purchased power	809,582	-	-	-	809,582	-
Accrued expenses	40,390	7,245	7,343	2,054	57,032	454
Customer deposits	7,069	500	-	-	7,569	-
Due to other funds	45,815	1,004,265	2,946	48,612	1,101,638	-
Due to other governments	-	-	-	7,713	7,713	-
Total current liabilities (payable from current assets)	<u>966,820</u>	<u>1,021,835</u>	<u>28,808</u>	<u>61,171</u>	<u>2,078,634</u>	<u>38,982</u>
Current liabilities (payable from restricted assets):						
Bonds payable	-	250,000	145,000	-	395,000	-
Accrued interest	-	35,476	6,100	-	41,576	-
Total current liabilities (payable from restricted assets)	<u>-</u>	<u>285,476</u>	<u>151,100</u>	<u>-</u>	<u>436,576</u>	<u>-</u>
Noncurrent liabilities:						
Accrued compensated absences	82,690	35,148	36,936	7,205	161,979	46,072
General obligation and revenue bonds payable	-	3,085,000	935,000	-	4,020,000	-
Total noncurrent liabilities	<u>82,690</u>	<u>3,120,148</u>	<u>971,936</u>	<u>7,205</u>	<u>4,181,979</u>	<u>46,072</u>
Total liabilities	<u>1,049,510</u>	<u>4,427,459</u>	<u>1,151,844</u>	<u>68,376</u>	<u>6,697,189</u>	<u>85,054</u>
Net Assets:						
Invested in capital assets, net of related debt	12,227,854	2,470,141	3,285,732	123,211	18,106,938	423,040
Restricted investments	-	633,871	591,990	-	1,225,861	-
Unrestricted (deficit)	8,695,210	(684,891)	1,694,557	4,912	9,709,788	347,390
Total net assets	<u>\$ 20,923,064</u>	<u>\$ 2,419,121</u>	<u>\$ 5,572,279</u>	<u>\$ 128,123</u>	<u>\$ 29,042,587</u>	<u>\$ 770,430</u>

See Notes to Financial Statements.

City of Hillsdale, Michigan
Statement of Revenues, Expenses
and Changes in Fund Net Assets
Proprietary Funds
Year Ended June, 2006

	Business-type Activities - Enterprise Funds					Governmental Activities
				Nonmajor Fund		Internal Service Funds
	Electric	Water	Sewer	Dial-A-Ride	Totals	
Operating Revenues:						
Charges for services	\$ 9,896,409	\$ 1,114,518	\$ 1,151,835	\$ 59,003	\$ 12,221,765	\$ 457,496
Other	-	-	-	-	-	158,919
Total operating revenues	<u>9,896,409</u>	<u>1,114,518</u>	<u>1,151,835</u>	<u>59,003</u>	<u>12,221,765</u>	<u>616,415</u>
Operating Expenses:						
Purchased power	6,604,746	-	-	-	6,604,746	-
Production expense	889,504	50,336	-	-	939,840	-
Purification expense	-	205,935	-	-	205,935	-
Treatment expense	-	-	508,912	-	508,912	-
Transmission and distribution	995,361	399,876	-	-	1,395,237	-
Administrative	752,007	223,519	241,364	-	1,216,890	593,187
Sewer collection	-	-	202,332	-	202,332	-
Transportation	-	-	-	429,267	429,267	-
Total operating expenses	<u>9,241,618</u>	<u>879,666</u>	<u>952,608</u>	<u>429,267</u>	<u>11,503,159</u>	<u>593,187</u>
Operating Income (Loss)	<u>654,791</u>	<u>234,852</u>	<u>199,227</u>	<u>(370,264)</u>	<u>718,606</u>	<u>23,228</u>
Nonoperating Revenues (Expenses):						
Interest income	71,761	16,567	49,234	-	137,562	10,478
Interest expense	-	(144,380)	(23,700)	-	(168,080)	-
Other income (expense)	<u>2,804</u>	<u>(7,756)</u>	<u>(4,168)</u>	<u>312,951</u>	<u>303,831</u>	<u>-</u>
Total nonoperating revenues (expenses)	<u>74,565</u>	<u>(135,569)</u>	<u>21,366</u>	<u>312,951</u>	<u>273,313</u>	<u>10,478</u>
Net Income (Loss) Before Transfers	729,356	99,283	220,593	(57,313)	991,919	33,706
Transfers in from Other Funds	-	-	-	57,950	57,950	-
Net Income (Loss)	729,356	99,283	220,593	637	1,049,869	33,706
Net Assets - Beginning of Year	<u>20,193,708</u>	<u>2,319,838</u>	<u>5,351,686</u>	<u>127,486</u>	<u>27,992,718</u>	<u>736,724</u>
Net Assets - End of Year	<u>\$ 20,923,064</u>	<u>\$ 2,419,121</u>	<u>\$ 5,572,279</u>	<u>\$ 128,123</u>	<u>\$ 29,042,587</u>	<u>\$ 770,430</u>

See Notes to Financial Statements

City of Hillsdale, Michigan
Statement of Cash Flows
Proprietary Funds
Year Ended June 30, 2006

	Business-type Activities - Enterprise Funds					Governmental Activities - Internal Service Funds
	Electric	Water	Sewer	Nonmajor Fund Dial-A-Ride	Total	
Cash Flows From Operating Activities:						
Cash received from customers, residents and users	\$ 9,868,676	\$ 1,115,682	\$ 1,143,864	\$ 59,003	\$12,187,225	\$ -
Other operating receipts	40,211	4,761	14,577	-	59,549	-
Receipts for interfund services provided	-	-	-	-	-	616,459
Cash paid to employees and suppliers	(9,191,560)	(631,395)	(803,690)	(365,321)	(10,991,966)	(492,633)
Net cash provided by (used in) operating activities	<u>717,327</u>	<u>489,048</u>	<u>354,751</u>	<u>(306,318)</u>	<u>1,254,808</u>	<u>123,826</u>
Cash Flows From Noncapital Financing Activities:						
Intergovernmental nonoperating revenues	-	-	-	312,951	312,951	-
Transfers from other funds	-	-	-	57,950	57,950	-
Net cash provided by noncapital financing activities	<u>-</u>	<u>-</u>	<u>-</u>	<u>370,901</u>	<u>370,901</u>	<u>-</u>
Cash Flows From Capital and Related Financing Activities:						
Bond payments on capital debt	-	(245,000)	(140,000)	-	(385,000)	-
Interest on capital debt	-	(144,380)	(24,400)	-	(168,780)	-
Purchase of capital assets, net	(990,678)	(91,109)	(40,312)	(73,410)	(1,195,509)	(116,643)
Net cash used by capital and related financing activities	<u>(990,678)</u>	<u>(480,489)</u>	<u>(204,712)</u>	<u>(73,410)</u>	<u>(1,749,289)</u>	<u>(116,643)</u>
Cash Flows From Investing Activities:						
Unrealized gain on investments	64,954	17,452	(13,789)	-	68,617	-
Purchase of investments	(99,734)	(35,019)	-	-	(134,753)	-
Other nonoperating income received	2,799	-	-	-	2,799	-
Other nonoperating expenses	-	(7,756)	(4,171)	-	(11,927)	-
Interest income received	70,830	16,764	49,234	-	136,828	10,478
Net cash provided by investing activities	<u>38,849</u>	<u>(8,559)</u>	<u>31,274</u>	<u>-</u>	<u>61,564</u>	<u>10,478</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>(234,502)</u>	<u>-</u>	<u>181,313</u>	<u>(8,827)</u>	<u>(62,016)</u>	<u>17,661</u>
Cash and Cash Equivalents - Beginning of Year	<u>1,606,645</u>	<u>-</u>	<u>188,868</u>	<u>77,416</u>	<u>1,872,929</u>	<u>241,918</u>
Cash and Cash Equivalents - End of Year	<u>\$ 1,372,143</u>	<u>\$ -</u>	<u>\$ 370,181</u>	<u>\$ 68,589</u>	<u>\$ 1,810,913</u>	<u>\$ 259,579</u>

Continued..

City of Hillsdale, Michigan
Statement of Cash Flows (Continued)
Proprietary Funds
Year Ended June 30, 2005

	Business-type Activities - Enterprise Funds					Governmental Activities - Internal Service Funds
	Electric	Water	Sewer	Nonmajor Fund Dial-A-Ride	Total	
Balance Sheet Classification of Cash						
Current assets - cash and cash equivalents	<u>\$ 1,372,143</u>	<u>\$ -</u>	<u>\$ 370,181</u>	<u>\$ 68,589</u>	<u>1,810,913</u>	<u>\$ 259,579</u>
Reconciliation of Operating Income (Loss)						
to Net Cash Provided by Operating Activities:						
Operating income (loss)	\$ 654,791	\$ 234,852	\$ 199,227	\$ (370,264)	718,606	\$ 23,228
Adjustments to reconcile operating income (loss)						
to net cash provided by (used in) operating activities:						
Depreciation	640,934	209,848	156,789	57,194	1,064,765	92,608
Changes in:						
Accounts receivable	17,622	6,414	6,606	-	30,642	44
Due from other funds	(12,008)	-	(25,090)	-	(37,098)	-
Inventory	4,374	4,929	(2,132)	-	7,171	(18,157)
Prepaid expenses	(2,049)	(2,550)	(2,288)	(572)	(7,459)	1,461
Investment in M.S.C.P.A.	(581,702)	-	-	-	(581,702)	-
Accounts payable	30,305	167	10,566	468	41,506	21,655
Accrued expenses	(53,593)	10,684	11,247	524	(31,138)	2,987
Customer deposits	(4,272)	(489)	-	-	(4,761)	-
Due to other funds	22,925	25,193	(174)	6,332	54,276	-
Net Cash Provided by (Used in) Operating Activities	<u>\$ 717,327</u>	<u>\$ 489,048</u>	<u>\$ 354,751</u>	<u>\$ (306,318)</u>	<u>\$ 1,254,808</u>	<u>\$ 123,826</u>

See Notes to Financial Statements.

City of Hillsdale, Michigan
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2006

	Hospital Private Purpose Trust Fund	Agency Funds
Assets:		
Cash and investments	\$ 14,788	\$ 10,058
Liabilities:		
Due to other agencies	-	\$ 10,058
Net Assets:		
Unrestricted	14,788	
Total net assets	\$ 14,788	

City of Hillsdale, Michigan
Statement of Changes in Fiduciary Net Assets
Fiduciary Funds
Year Ended June 30, 2006

	<u>Hospital Private Purpose Trust Fund</u>
Revenue:	
Interest income	\$ 591
Expenses:	
Other	<u>758</u>
Change in Net Assets	(167)
Net Assets - Beginning of Year	<u>14,955</u>
Net Assets - End of Year	<u>\$ 14,788</u>

See Notes to Financial Statements.

City of Hillsdale, Michigan

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies

The City of Hillsdale, Michigan was organized in 1847 and covers an area of approximately 5.5 square miles in Hillsdale County. In 1957, the City adopted the Home Rule Charter. The City operates under a Council-Manager form of government and provides the following services as authorized by its charter to its more than 8,233 residents (2000 census): public safety (police and fire), highways and streets, sanitation, health, housing, recreation, public improvements, planning and zoning, and general administrative services.

The financial statements of the City of Hillsdale have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the government's accounting policies are described below.

Reporting Entity

The City of Hillsdale (the "City") has followed the guidelines of the Governmental Accounting Standards Board's Statement No. 34. As required by generally accepted accounting principles, the financial statements of the reporting entity include those of the City (the primary government) and its component units. The component units discussed below are included in the City's reporting entity because the City is considered to be financially accountable for them.

In conformity with generally accepted accounting principles, the financial statements of the component units are included in the reporting entity as discretely presented component units.

Discretely Presented Component Units – The component unit columns in the combined financial statements include the financial data of the City's two component units. These units are reported in separate columns to emphasize that they are legally separate from the City:

Tax Increment Finance Authority – Operated as a separate Board, this Authority is responsible for directing improvements to a District in the City of Hillsdale using funds derived from the capturing of real and personal property taxes within that District. The City has the ability to significantly influence operations and has accountability for fiscal matters.

Economic Development Corporation – This entity is governed by a separate Board appointed by the City Council to grant loans to businesses operating in the City.

Brownfield Redevelopment Authority - This entity was established in order to revitalize environmentally distressed areas within a Brownfield Redevelopment Area and is operated by a separate Board. To date, the Authority has had no activity.

The financial statements of the Hillsdale Housing Commission are excluded from the accompanying financial statements since the Housing Commission's operating and capital expenditures, including debt service, are financed entirely from federal grants and rentals. The City has no involvement in the determination of the Housing Commission's budget and rental rates, and has no obligation for the Housing Commission's outstanding debt. Summarized financial statements as of and for the year ended June 30, 2005, the date of their most recently prepared audited financial statements, are as follows:

Revenue	\$297,840	Assets	\$1,277,027
Expenses	434,687	Liabilities	36,618
Excess expenses over revenues	(136,847)	Fund equity	1,240,409
Other income (net)	215		
Net loss	(136,632)		

City of Hillsdale, Michigan
Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-Wide Statements - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the government's water and sewer funds and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

**Measurement Focus, Basis of Accounting, and Financial Statement Presentation
(Continued)**

Fund-Based Statements - Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available if they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences, claims, and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The government reports the following major governmental funds:

General Fund – This fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

Capital Improvement Fund – This fund is used to account for the financial resources to be used for the construction of major capital facilities projects (other than those financed by proprietary and trust funds).

The government reports the following major proprietary funds:

Electric Fund – The electric fund accounts for the activities of the government's electric generation and distribution system.

Water Fund – The water fund accounts for the activities of the government's water production, purification, and distribution systems.

Sewer Fund – The sewer fund accounts for the activities of the government's sewage collection and treatment systems.

Additionally, the government reports the following fund types:

Special Revenue Funds – These funds account for revenue sources that are legally restricted to expenditures for specific purposes (not including major capital projects).

Debt Service Fund – The debt service fund is used to account for the accumulation of resources for and the payment of principal and interest on long-term general obligation debt of governmental funds not being financed by proprietary funds.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

**Measurement Focus, Basis of Accounting, and Financial Statement Presentation
(Continued)**

Capital Project Funds – These funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary and trust funds).

Internal Service Funds – The internal service funds account for operations that provide services (such as leave and benefits, inventory purchasing, equipment rental and unemployment insurance) to other departments of the City on a cost-reimbursement basis.

R.L. Owen Memorial Fund – This permanent fund accounts for monies held in trust to be used for the activities specified in the related trust agreement.

Cemetery Perpetual Fund – This permanent fund accounts for monies held in trust to be used for the perpetual care of cemetery lots.

Dial-A-Ride Fund – This fund accounts for the operations of the local transportation system in the City of Hillsdale.

Hospital Private Purpose Trust Fund – This fund accounts for contributions earmarked for hospital care.

Agency Funds – These funds account for assets held for other governments in an agency capacity.

Additional Financial Statement Presentation Information - Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the electric, water and sewer enterprise funds and of the government's internal service fund are charges to customers for sales and services. The enterprise funds also recognize as operating revenues the portion of fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, then unrestricted resources as they are needed.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Deposits and Investments – The government's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

State statutes authorize the government to deposit in the accounts of federally insured banks, credit unions, and savings and loan associations, and to invest in obligations of the U.S.

Treasury, certain commercial paper, repurchase agreements, bankers' acceptances, and mutual funds composed of otherwise legal investments.

Investments are reported at fair value.

Receivables and Payables – All receivables are reported at their net value. They are reduced, where appropriate, by the estimated portion that is expected to be uncollectible.

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Inventory – Inventory is valued at cost, which approximates market, using the first-in, first-out method. Inventory of the Hillsdale Board of Public Utilities (reported as business-type activities, major proprietary funds) are valued using the average cost method. Inventories of governmental funds are recorded as expenditures when purchased.

Prepaid Items – Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Restricted Assets – Certain proceeds of the Enterprise Funds' revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. Also, certain resources have been set aside to fund capital asset replacements.

Capital Assets – Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Capital Assets (Continued) - Capital assets of the primary government are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Land improvements	20
Buildings and improvements	50
Vehicles	5 - 12
Books	7
Equipment and vehicles	5 - 20
Infrastructure	15 - 50
Plant and systems	10 - 65

Compensated Absences – It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Vacation, sick and personal days are accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if the obligation is expected to be liquidated from expendable available financial resources.

Long-Term Obligations – In the government-wide financial statements (Statement of Net Assets) and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund types. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Fund Equity – In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

Property Taxes - The government's property taxes are levied each July 1 on the taxable valuation of property located in the City as of the preceding December 31, the lien date. Property taxes are payable without penalty and interest through August 31; as of March 1 of the succeeding year, unpaid real property taxes are sold to and collected by Hillsdale County.

Assessed values as established annually by the government, and subject to acceptance by the County, are equalized by the State at an estimated 50% of current market value. Real and personal property in the City for 2005 had a taxable value of approximately \$151,875,000 (not including properties subject to Industrial Facilities Tax exemption), representing 50% of estimated current market value. The government's general operating tax rate for fiscal year 2005-06 was 14.9205 mills, with an additional .9947 mills levied for operations of the Mitchell Public Library.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Property Taxes (Continued) - Property taxes for the Tax Increment Finance Authority (TIFA) are derived from a tax increment financing agreement between the TIFA and other related taxing districts. Under this arrangement, the TIFA receives those property taxes levied on the increment of current taxable valuations (determined as of the preceding December 31, the lien date) over base year assessed valuations on certain property located in the City of Hillsdale, which are within the DDA district. Property taxes are recognized in the fiscal year in which they are levied.

Note 2 - Stewardship, Compliance and Accountability

Budgetary Information

Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America for the General and Special Revenue Funds. All annual appropriations lapse at fiscal year end.

The City Manager submits to the City Council a proposed operating budget for the fiscal year commencing July 1. The operating budget includes proposed expenditures and the means of financing them. The Council holds public hearings and a final budget must be prepared and adopted prior to July 1.

The City Manager is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the City Council. The adopted budgets of the City for these budgetary funds were adopted on a functional basis for the General Fund and a fund basis for the Special Revenue Funds. Budgets for the General and Special Revenue Funds are adopted on a basis consistent with generally accepted accounting principles (GAAP).

Excess of Expenditures Over Appropriations

For the year ended June 30, 2006, expenditures that exceeded appropriations in the General Fund are disclosed in the Required Supplemental Information on pages 30-31.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 3 – Cash and Investments

A reconciliation of cash and investments as shown on the Statement of Net Assets and Statement of Fiduciary Net Assets to deposits and investments as classified for note disclosure purposes is as follows:

	<u>Primary Government</u>	<u>Component Units</u>
Statement of Net Assets:		
Cash and investments	\$7,794,155	\$ 317,052
Statement of Fiduciary Net Assets:		
Hospital Private Purpose Trust Fund:		
Cash and investments	14,788	-
Agency Funds:		
Cash and investments	<u>10,058</u>	<u>-</u>
	<u>\$7,819,001</u>	<u>\$ 317,052</u>
	<u>Primary</u>	<u>Component</u>
	<u>Government</u>	<u>Unit(s)</u>
Bank deposits (checking accounts, savings accounts and short-term CDs)	\$2,220,483	\$ (4,656)
Investments in securities, mutual funds and similar vehicles	5,596,168	321,708
Cash on hand	<u>2,350</u>	<u>-</u>
	<u>\$7,819,001</u>	<u>\$ 317,052</u>

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. State law limits the allowable investments and the maturities of some of the allowable investments as identified in Note 1. The City's investment policy does not have specific limits in excess of State law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. Information about the sensitivity of the fair values of the City's investments to market interest rate fluctuations is provided in the following table that shows the distribution of the City's investments by maturity.

Rating S&P	Rating Moody's	Investment Type	Remaining Maturity		
			12 Months or Less	1 to 5 Years	Greater Than 5 Years
N/A	N/A	Certificates of Deposit	\$ 700,000	\$ 99,326	\$ 0
NR	NR	Local Units of Government Investments Pool	5,263	0	0
NR	NR	Michigan CLASS Investments Pool	983,163	0	0
AAA	Aaa	U.S. Government Agency Bonds	0	3,090,889	320,926
AAA	Aaa	Financing Corporation Bond	0	0	27,800
N/A	N/A	Money Market Fund	3,688	0	0
N/A	N/A	Spartan U.S. Government Money Market	656,796	0	0
N/A	N/A	Fidelity Investment Cash	15,237	0	0

City of Hillsdale, Michigan
Notes to Financial Statements

Note 3 – Cash and Investments (Continued)

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented above is the actual rating as of year-end for each investment type.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the name of the local unit. The City has not adopted and State law does not require a policy for deposit custodial credit risk. As of year-end, \$2,428,183 of the City's bank balance of \$3,052,016 was exposed to custodial credit risk because it was uninsured and uncollateralized.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Michigan law and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments. As of year-end, City investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the City to buy the securities - Federal agency securities in the reported amount of \$3,411,815.

Note 4 – Receivables

Receivables of the governmental activities of the primary government at June 30, 2006, consist of the following:

Other governmental units (primarily the State of Michigan)	\$219,449
Accounts receivable	127,532
Special assessments	<u>329,496</u>
	<u>\$676,477</u>

City of Hillsdale, Michigan
Notes to Financial Statements

Note 5 - Capital Assets

Capital assets activity for the year ended June 30, 2006 was as follows:

Primary Government	Beginning Balance	Additions	Disposals and Adjustments	Ending Balance
Governmental Activities:				
Capital assets not being depreciated:				
Land	\$3,271,793	\$ 180,000	\$ -	\$3,451,793
Capital assets being depreciated:				
Land improvements	210,035	35,464	-	245,499
Buildings and improvements	4,706,677	28,315	-	4,734,992
Books	454,622	19,770	-	474,392
Equipment and vehicles	2,414,923	124,989	20,298	2,519,614
Infrastructure	27,059,653	924,131	2,432,617	25,551,167
Total capital assets being depreciated	34,845,910	1,132,669	2,452,915	33,525,664
Accumulated depreciation:				
Land improvements	104,325	9,875	-	114,200
Buildings and improvements	949,172	91,142	-	1,040,314
Books	410,170	10,342	-	420,512
Equipment and vehicles	1,549,655	143,593	20,298	1,672,950
Infrastructure	15,706,038	1,035,872	2,432,617	14,309,293
Total accumulated depreciation	18,719,360	1,290,824	2,452,915	17,557,269
Total capital assets being depreciated - net	16,126,550	(158,155)	-	15,968,395
Governmental activities capital assets - net	\$19,398,343	\$ 21,845	\$ -	\$19,420,188
Business-Type Activities				
Capital assets not being depreciated:				
Land	\$ 189,982	\$ -	\$ -	\$ 189,982
Construction in progress	232,266	252,861	117,194	367,933
Total capital assets not being depreciated	422,248	252,861	117,194	557,915
Capital assets being depreciated:				
Equipment	416,261	73,410	-	489,671
Plant and systems	50,889,788	986,431	22,990	51,853,229
Total capital assets being depreciated	51,306,049	1,059,841	22,990	52,342,900
Accumulated depreciation:				
Equipment	309,266	57,194	-	366,460
Plant and systems	29,027,837	1,007,570	22,990	30,012,417
Total accumulated depreciation	29,337,103	1,064,764	22,990	30,378,877
Total capital assets being depreciated - net	21,968,946	(4,923)	-	21,964,023
Business-type activities capital assets - net	\$22,391,194	\$ 247,938	\$ 117,194	\$22,521,938

City of Hillsdale, Michigan
Notes to Financial Statements

Note 5 - Capital Assets (Continued)

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities:	
Public safety	\$ 43,707
Highways and streets	972,444
Culture and recreation	95,825
Public works	49,873
Unallocated	36,367
Capital assets held by the City's internal service funds are charged to the various functions based on their usage of the assets	<u>92,608</u>
Total depreciation expense – governmental activities	<u>\$ 1,290,824</u>
Business-Type Activities:	
Electric	\$ 640,934
Water	209,848
Sewer	156,788
Transportation	<u>57,194</u>
Total depreciation expense – business-type activities	<u>\$ 1,064,764</u>

Note 6 - Interfund Receivables, Payables and Transfers

The City reports interfund balances between many of its funds. The sum of all balances presented in the tables below agrees with the sum of interfund balances presented in the statements of net assets/balance sheet for governmental funds and proprietary funds. These interfund balances resulted primarily from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

	<u>Receivable</u>	<u>Payable</u>
Due from/to other funds:		
General Fund	\$ 86,159	\$ -
Nonmajor Governmental Funds	-	3,762
Water Fund	-	1,004,265
Sewer Fund	1,001,735	2,946
Electric Fund	17,506	45,815
Nonmajor Enterprise Fund	-	48,612
	<u>\$1,105,400</u>	<u>\$ 1,105,400</u>
	<u>Transfers In</u>	<u>Transfers Out</u>
Transfers:		
General Fund	\$ 22,000	\$ 788,980
Capital Improvement	653,164	-
Nonmajor Governmental Funds	412,360	354,641
Component Units	-	1,853
Nonmajor Enterprise Fund	<u>57,950</u>	<u>-</u>
	<u>\$1,145,474</u>	<u>\$ 1,145,474</u>

City of Hillsdale, Michigan
Notes to Financial Statements

Note 6 - Interfund Receivables, Payables and Transfers (Continued)

Transfers are used to: (1) move revenues from the fund that is required to collect them to the fund that is required or allowed to expend them; (2) move receipts restricted to or allowed for debt service from the funds collecting the receipts to the debt service fund as debt service payments become due; and (3) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

Note 7 - Investment in Michigan South Central Power Agency

The Michigan South Central Power Agency (M.S.C.P.A.) was organized in 1978 under the authority of Michigan Public Act 448 of 1976, to supply electricity to member municipalities in South Central Michigan. The Act provides that the agency will establish rates and charges to produce revenues sufficient to cover its costs, but may not operate for profit, except for the benefit of the public. The agency is governed by a Board of Commissioners which is comprised of one representative from each participating municipality and the general manager of the agency.

Participating municipalities and their respective shares of ownership are as follows:

	<u>Percent of Ownership</u>
City of Coldwater	40.0%
City of Hillsdale	25.5
City of Marshall	24.0
Village of Clinton	6.5
Village of Union City	<u>4.0</u>
	<u>100.0%</u>

The City of Hillsdale Board of Public Utilities is accounting for its investment in M.S.C.P.A. as a joint venture in accordance with GASB Statement No. 14. Information presented below is taken from financial statements of the M.S.C.P.A. for the year ended June 30, 2006, audited by other auditors whose report dated August 10, 2006, expressed an unqualified opinion for those statements.

The Board has entered into a Power Sales Contract with M.S.C.P.A. which requires the Board to purchase all of its bulk power supply from M.S.C.P.A. and to pay its share of the agency's operating and debt service costs. The Board has also entered into an agreement for services to be provided by the M.S.C.P.A. in respect to substation facilities and an agreement which requires the Board to sell to the agency power generated by its facilities in certain instances.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 7 - Investment in Michigan South Central Power Agency (Continued)

Summary information of the Hillsdale Board of Public Utilities investment in the M.S.C.P.A. as of and for the year ended June 30, 2006, is as follows:

	<u>Total M.S.C.P.A.</u>	<u>Hillsdale Board of Public Utilities Portion 25.5%</u>
Total assets	\$76,241,628	\$19,441,615
Total liabilities	<u>58,736,861</u>	<u>14,977,900</u>
Net Assets	<u>\$17,504,767</u>	<u>\$ 4,463,715</u>
Operating revenues	\$44,961,391	\$11,465,155
Operating expenses	<u>37,275,616</u>	<u>9,505,282</u>
Operating Income	7,685,775	1,959,873
Other income and expenses	<u>(5,404,589)</u>	<u>(1,378,171)</u>
Changes in Net Assets	2,281,186	581,702
Net Assets, Beginning of Year	<u>15,223,581</u>	<u>3,882,013</u>
Net Assets, End of Year	<u>\$17,504,767</u>	<u>\$ 4,463,715</u>

Note 8 - Long-Term Debt

General Obligation Bonds - The government issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities. General obligation bonds have been issued for governmental activities. No general obligation bonds were issued during the current year.

Other Obligations - The government has entered into various long-term loan and installment contract agreements.

Loan and installment obligations currently outstanding are as follows:

<u>Purpose</u>	<u>Due in Fiscal Year End</u>	<u>Interest Rates</u>	<u>Amount</u>
Governmental Activities:			
Other government debt:			
Loan – Strategic Loan Fund – Road improvements	2013	0.00%	\$ 400,000
Municipal purchase contract - Library building improvements	2013	4.19%	455,000
Loan – Community Development Block Grant – Industrial park property acquisitions	2013	0.00%	<u>196,000</u>
			<u>\$1,051,000</u>

City of Hillsdale, Michigan
Notes to Financial Statements

Note 8 - Long-Term Debt (Continued)

Annual debt service requirements to maturity for the loan and municipal service contract obligations are as follows:

<u>Year Ending June 30,</u>	<u>Other Governmental Debt</u>	
	<u>Principal</u>	<u>Interest</u>
2007	\$ 148,000	18,331
2008	148,000	15,398
2009	148,000	12,465
2010	148,000	9,532
2011	148,000	6,599
2012 – 2014	<u>311,000</u>	<u>4,400</u>
Total	<u>\$1,051,000</u>	<u>\$ 66,725</u>

Revenue Bonds - The government also issues bonds where the government pledges income derived from the acquired or constructed assets to pay debt service. No revenue bonds were issued during the current year. Revenue bonds outstanding at year end are as follows:

<u>Business-Type Activities</u>	<u>Due in Fiscal Year End</u>	<u>Interest Rates</u>	<u>Amount</u>
1999 Water	2019	4.75% - 5.10%	\$1,855,000
2002 Water Refunding	2015	3.00% - 4.00%	1,480,000
1992 Sewer	2013	2%	<u>1,080,000</u>
			<u>\$4,415,000</u>

Revenue bond debt service requirements to maturity are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 395,000	\$ 158,789
2008	410,000	146,314
2009	420,000	133,396
2010	430,000	120,010
2011	445,000	105,732
2012 – 2016	1,780,000	296,525
2017 – 2019	<u>535,000</u>	<u>41,515</u>
Total	<u>\$4,415,000</u>	<u>\$1,002,281</u>

City of Hillsdale, Michigan
Notes to Financial Statements

Note 8 - Long-Term Debt (Continued)

Long-term liability activity for the year ended June 30, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Primary Government					
Governmental activities:					
Contract and loans payable	\$1,199,000	\$ -	\$ 148,000	\$1,051,000	\$ 148,000
Compensated absences	<u>220,112</u>	<u>18,241</u>	<u>-</u>	<u>238,353</u>	<u>34,150</u>
	<u>\$1,419,112</u>	<u>\$ 18,241</u>	<u>\$ 148,000</u>	<u>\$1,289,353</u>	<u>\$ 182,150</u>
Business-type activities:					
Revenue bonds	\$4,800,000	\$ -	\$ 385,000	\$4,415,000	\$ 395,000
Compensated absences	<u>146,017</u>	<u>15,962</u>	<u>-</u>	<u>161,979</u>	<u>4,369</u>
	<u>\$4,946,017</u>	<u>\$ 15,962</u>	<u>\$ 385,000</u>	<u>\$4,576,979</u>	<u>\$ 399,369</u>

For the governmental activities, compensated absences are generally liquidated by the General Fund.

Note 9 - Segment Information – Enterprise Funds

The government issued revenue bonds to finance certain improvements to its water and sewer distribution and treatment systems. Because the Water and Sewer Funds, which are individual funds that account entirely for the government's water distribution and treatment and sewage disposal and treatment activities, are segments, and are reported as major funds in the fund financial statements, segment disclosures herein are not required.

Note 10 - Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the year ended June 30, 2006, the City carried commercial insurance to cover all risks of losses. The City has had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years.

Note 11 - Pension Plan

Plan Description - The City's defined benefit pension plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The City participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer plan administered by the Retirement Board of MERS. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 447 N. Canal Road, Lansing, Michigan 48917, or by calling (800) 767-6377.

City of Hillsdale, Michigan
Notes to Financial Statements

Note 11 - Pension Plan (Continued)

Funding Policy - The City is required to contribute at an actuarially determined rate designed to accumulate sufficient assets to pay benefits when due. Employees are currently required to contribute 3-5% of covered wages to the Plan. The contribution requirements of the City are established by Act No. 427 of the Public Acts of 1984, as amended, and may be amended by the Retirement Board of MERS. The contribution requirements of plan members, if any, are established and may be amended by the City.

Annual Pension Cost - For the year ended June 30, 2006, the City's pension cost of \$156,136 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the December 31, 2004 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) a rate of return on the investment of present and future assets of 8.0%, (b) projected salary increases of 4.5% per year compounded annually, attributable to inflation, and (c) additional projected salary increases of 0.0% to 4.2% per year, depending on age, attributable to seniority/merit. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return, and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability at December 31, 2005, the date of the latest actuarial valuation, is being amortized as a level percentage of projected payroll on an open basis over 30 years.

Three-Year Trend Information

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/20/04	\$ 38,000	100%	\$ -
6/30/05	100,000	100%	-
6/30/06	156,000	100%	-

Schedule of Funding Progress

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL) – Entry Age</u>	<u>Assets in Excess of AAL</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
12/31/03	\$13,943,123	\$12,682,283	\$1,260,840	116%	\$3,684,530	-%
12/31/04	14,500,440	13,695,079	805,361	106	3,674,352	-
12/31/05	15,055,122	14,417,814	637,308	104	3,624,840	-

Note 12 - Commitments and Contingencies

The City participates in a number of federally-assisted grant programs. These programs are subject to program compliance audits. Accordingly, the City's compliance with applicable grant requirements will be established at some future date. The amount, if any, of expenditures which may be disallowed by granting agencies cannot be determined at this time although the City expects such amounts, if any, to be immaterial.

Required Supplemental Information

City of Hillsdale, Michigan
 Budgetary Comparison Schedule
 General Fund
 Year Ended June 30, 2006

	<u>Budgeted Amounts</u>		
	<u>Original</u>	<u>Final</u>	<u>Actual</u>
Revenues:			
City taxes:			
Property	\$ 2,103,000	\$ 2,203,000	\$ 2,126,464
Administrative fees	70,000	70,000	73,662
Interest and penalties	25,000	25,000	45,993
Industrial facilities tax	<u>100,000</u>	<u>100,000</u>	<u>100,048</u>
Total city taxes	2,298,000	2,398,000	2,346,167
 State revenue	893,500	933,500	934,811
Federal revenue	-	-	7,081
Other revenue	<u>1,030,300</u>	<u>1,205,300</u>	<u>1,139,884</u>
 Total revenues	<u>4,221,800</u>	<u>4,536,800</u>	<u>4,427,943</u>
 Expenditures:			
General government:			
Council	31,950	31,950	30,351
Clerk	121,635	123,835	125,039
City manager	198,970	204,370	196,936
Assistant city manager	80,950	83,150	77,817
Economic development	-	100,000	17,877
Administrative	162,600	162,600	159,786
Treasurer	115,965	206,765	218,366
Street lights	50,400	50,400	51,246
Airport	81,240	91,240	85,181
Finance department	90,645	92,845	88,160
General operation	<u>141,505</u>	<u>141,505</u>	<u>119,313</u>
Total general government	<u>1,075,860</u>	<u>1,288,660</u>	<u>1,170,072</u>
 Public safety:			
Police	1,313,120	1,353,120	1,269,008
Fire	<u>362,875</u>	<u>402,875</u>	<u>362,068</u>
Total public safety	<u>1,675,995</u>	<u>1,755,995</u>	<u>1,631,076</u>
 Public works:			
Public services	407,610	412,010	378,592
Cemetery	<u>80,530</u>	<u>80,530</u>	<u>97,844</u>
Total public works	<u>488,140</u>	<u>492,540</u>	<u>476,436</u>

Continued..

City of Hillsdale, Michigan
 Budgetary Comparison Schedule (Continued)
 General Fund
 Year Ended June 30, 2006

	Budgeted Amounts		Actual
	Original	Final	
Expenditures (Concluded):			
Health:			
Assessor	\$ 135,600	\$ 138,400	\$ 125,287
Building inspector	<u>37,690</u>	<u>37,690</u>	<u>27,748</u>
Total health	<u>173,290</u>	<u>176,090</u>	<u>153,035</u>
Culture and recreation	<u>120,285</u>	<u>155,285</u>	<u>152,957</u>
Total expenditures	<u>3,533,570</u>	<u>3,868,570</u>	<u>3,583,576</u>
Revenues Over (Under) Expenditures	<u>688,230</u>	<u>668,230</u>	<u>844,367</u>
Other Financing Sources (Uses):			
Transfers in	37,000	37,000	22,000
Transfers out	<u>(725,230)</u>	<u>(1,025,230)</u>	<u>(788,980)</u>
Total other financing sources (uses)	<u>(688,230)</u>	<u>(988,230)</u>	<u>(766,980)</u>
Net Changes in Fund Balances	-	(320,000)	77,387
Fund Balances - Beginning of Year	<u>645,276</u>	<u>645,276</u>	<u>645,276</u>
Fund Balances - End of Year	<u>\$ 645,276</u>	<u>\$ 325,276</u>	<u>\$ 722,663</u>

Other Supplemental Information

City of Hillsdale, Michigan
Combining Balance Sheet
Nonmajor Governmental Funds
June 30, 2006

	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Permanent Funds</u>	<u>Total</u>
<u>Assets</u>					
Cash and cash equivalents	\$ 221,392	\$ 5,732	\$ 161,989	\$ 114,474	\$ 503,587
Investments, at cost	-	-	-	443,628	443,628
Accounts receivable	59,932	-	2,946	-	62,878
Due from other governmental agencies	95,125	-	-	-	95,125
Prepaid expenditures	1,829	-	-	-	1,829
Total assets	<u>\$ 378,278</u>	<u>\$ 5,732</u>	<u>\$ 164,935</u>	<u>\$ 558,102</u>	<u>\$ 1,107,047</u>
<u>Liabilities and Fund Balances</u>					
Liabilities:					
Accounts payable	\$ 19,744	\$ -	\$ 3,114	\$ -	\$ 22,858
Accrued payroll and related liabilities	7,077	-	-	-	7,077
Due to other funds	3,762	-	-	-	3,762
Total liabilities	<u>30,583</u>	<u>-</u>	<u>3,114</u>	<u>-</u>	<u>33,697</u>
Fund Balances:					
Reserved for prepaid items	1,829	-	-	-	1,829
Reserved for perpetual care and endowment	-	-	-	558,102	558,102
Unreserved:					
Unreserved; undesignated	345,866	5,732	161,821	-	513,419
Total fund balances	<u>347,695</u>	<u>5,732</u>	<u>161,821</u>	<u>558,102</u>	<u>1,073,350</u>
Total liabilities and fund balances	<u>\$ 378,278</u>	<u>\$ 5,732</u>	<u>\$ 164,935</u>	<u>\$ 558,102</u>	<u>\$ 1,107,047</u>

City of Hillsdale, Michigan
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended June 30, 2006

	<u>Special Revenue</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Permanent Funds</u>	<u>Total</u>
Revenues:					
Taxes	\$ 148,829	\$ -	\$ -	\$ -	\$ 148,829
Intergovernmental - federal and State	655,264	-	-	-	655,264
Charges for services	87,454	-	-	13,926	101,380
Fines and violations	57,605	-	-	-	57,605
Miscellaneous	<u>47,770</u>	<u>-</u>	<u>107,495</u>	<u>15,818</u>	<u>171,083</u>
Total revenues	<u>996,922</u>	<u>-</u>	<u>107,495</u>	<u>29,744</u>	<u>1,134,161</u>
Expenditures:					
Public safety	9,807	-	-	-	9,807
Highways and streets	745,399	-	-	-	745,399
Culture and recreation	337,084	-	-	-	337,084
Debt service:					
Principal payments	-	148,000	-	-	148,000
Interest and fiscal charges	-	21,264	-	-	21,264
Capital outlay	<u>-</u>	<u>-</u>	<u>62,090</u>	<u>-</u>	<u>62,090</u>
Total expenditures	<u>1,092,290</u>	<u>169,264</u>	<u>62,090</u>	<u>-</u>	<u>1,323,644</u>
Revenues Over (Under) Expenditures	<u>(95,368)</u>	<u>(169,264)</u>	<u>45,405</u>	<u>29,744</u>	<u>(189,483)</u>
Other Financing Sources (Uses):					
Operating transfers in	172,590	169,270	70,500	-	412,360
Operating transfers out	<u>(222,500)</u>	<u>-</u>	<u>(91,270)</u>	<u>(40,871)</u>	<u>(354,641)</u>
Total other financing sources (uses)	<u>(49,910)</u>	<u>169,270</u>	<u>(20,770)</u>	<u>(40,871)</u>	<u>57,719</u>
Changes in Fund Balances	<u>(145,278)</u>	<u>6</u>	<u>24,635</u>	<u>(11,127)</u>	<u>(131,764)</u>
Fund Balances - Beginning of Year	<u>492,973</u>	<u>5,726</u>	<u>137,186</u>	<u>569,229</u>	<u>1,205,114</u>
Fund Balances - End of Year	<u>\$ 347,695</u>	<u>\$ 5,732</u>	<u>\$ 161,821</u>	<u>\$ 558,102</u>	<u>\$ 1,073,350</u>

City of Hillsdale, Michigan
Combining Balance Sheet
Nonmajor Special Revenue Funds
June 30, 2006

Assets

	Library	Recreation	Commission	Drug	Police	Public	Relations	Major	Local	Fire	Total
				Forfeitures				Street	Street	Equipment	
Cash and cash equivalents	\$ 107,419	\$ 394	\$ 104	\$ 104	\$ 10,067	\$ 10,067	\$ 35,846	\$ 51,640	\$ 15,922	\$ 221,392	
Accounts receivable	58,047	1,885	-	-	-	-	-	-	-	-	59,932
Due from other governmental agencies	-	-	-	-	-	-	71,563	23,562	-	-	95,125
Prepaid expenditures	256	1,573	-	-	-	-	-	-	-	-	1,829
Total assets	\$ 165,722	\$ 3,852	\$ 104	\$ 104	\$ 10,067	\$ 10,067	\$ 107,409	\$ 75,202	\$ 15,922	\$ 378,278	

Liabilities and Fund Balances

Liabilities:

Accounts payable	\$ 1,771	\$ 613	\$ -	\$ -	\$ -	\$ 13,379	\$ 3,981	\$ -	\$ 19,744
Accrued salaries and related liabilities	1,783	2,519	-	-	-	1,698	1,077	-	7,077
Due to other funds	3,762	-	-	-	-	-	-	-	3,762
Total liabilities	7,316	3,132	-	-	-	15,077	5,058	-	30,583

Fund Balances:

Reserved for prepaid items	256	1,573	-	-	-	-	-	-	1,829
Unreserved; undesignated	158,150	(853)	104	10,067	10,067	92,332	70,144	15,922	345,866
Total fund balances	158,406	720	104	10,067	10,067	92,332	70,144	15,922	347,695
Total liabilities and fund balances	\$ 165,722	\$ 3,852	\$ 104	\$ 104	\$ 10,067	\$ 107,409	\$ 75,202	\$ 15,922	\$ 378,278

City of Hillsdale, Michigan

Changes in Fund Balances

Year Ended June 30, 2006

Revenues:

Public safety

Culture and recreation

Total expenditures

Other Financing Sources (Uses):

Transfers out

Total other financing sources (uses)

Fund Balances - Beginning of Year

Fund Balances - End of Year

City of Hillsdale, Michigan
Combining Balance Sheet
Nonmajor Debt Service Funds
June 30, 2006

		<u>Bond and Interest</u>
	<u>Assets</u>	
Cash and cash equivalents		<u>\$ 5,732</u>
	<u>Fund Balance</u>	
Unreserved; undesignated		<u>5,732</u>
Total fund balance		<u>\$ 5,732</u>

City of Hillsdale, Michigan
Combining Statement of Revenues, Expenditures, and
Changes in Fund Balances
Nonmajor Debt Service Funds
Year Ended June 30, 2006

	<u>Bond and Interest</u>
Revenues:	
Interest income	\$ -
Expenditures:	
Principal retirement	148,000
Interest and fiscal charges	<u>21,264</u>
Total expenditures	<u>169,264</u>
Revenues Under Expenditures	(169,264)
Other Financing Sources:	
Transfers in	<u>169,270</u>
Changes in Fund Balance	6
Fund Balance - Beginning of Year	<u>5,726</u>
Fund Balance - End of Year	<u><u>\$ 5,732</u></u>

City of Hillsdale, Michigan
Combining Balance Sheet
Nonmajor Capital Project Funds
June 30, 2006

	<u>Library</u>	<u>Airport</u>	<u>Three</u>	<u>Field of</u>	<u>Stock</u>	
	<u>Improvement</u>	<u>Improvement</u>	<u>Meadows</u>	<u>Dreams</u>	<u>Park</u>	<u>Total</u>
<u>Assets</u>						
Cash and cash equivalents	\$ 287	\$ 138,261	\$ 423	\$ 1,044	\$ 21,974	\$ 161,989
Accounts receivable	-	2,946	-	-	-	2,946
Due from other agencies	-	-	-	-	-	-
Total assets	<u>\$ 287</u>	<u>\$ 141,207</u>	<u>\$ 423</u>	<u>\$ 1,044</u>	<u>\$ 21,974</u>	<u>\$ 164,935</u>
<u>Liabilities and Fund Balances</u>						
Liabilities:						
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ 3,114	\$ 3,114
Fund Balances:						
Unreserved; undesignated	287	141,207	423	1,044	18,860	161,821
Total fund balances	<u>287</u>	<u>141,207</u>	<u>423</u>	<u>1,044</u>	<u>18,860</u>	<u>161,821</u>
Total liabilities and fund balances	<u>\$ 287</u>	<u>\$ 141,207</u>	<u>\$ 423</u>	<u>\$ 1,044</u>	<u>\$ 21,974</u>	<u>\$ 164,935</u>

City of Hillsdale, Michigan
Combining Statement of Revenues, Expenditures, and
Changes in Fund Balances
Nonmajor Capital Project Funds
Year Ended June 30, 2006

	<u>Library Improvement</u>	<u>Airport Improvement</u>	<u>Three Meadows</u>	<u>Field of Dreams</u>	<u>Stock Park</u>	<u>Total</u>
Revenues:						
Miscellaneous	\$ 63,322	\$ 21,438	\$ -	\$ 41	\$ 22,694	\$ 107,495
Expenditures:						
Capital outlay	17,366	24,854	400	-	19,470	62,090
Total expenditures	17,366	24,854	400	-	19,470	62,090
Revenues Over (Under) Expenditures	45,956	(3,416)	(400)	41	3,224	45,405
Other Financing Sources (Uses):						
Transfers in	45,500	25,000	-	-	-	70,500
Transfers out	(91,270)	-	-	-	-	(91,270)
Total other financing sources (uses)	(45,770)	25,000	-	-	-	(20,770)
Changes in Fund Balances	186	21,584	(400)	41	3,224	24,635
Fund Balances - Beginning of Year	101	119,623	823	1,003	15,636	137,186
Fund Balances - End of Year	\$ 287	\$ 141,207	\$ 423	\$ 1,044	\$ 18,860	\$ 161,821

City of Hillsdale, Michigan

Combining Balance Sheet

Nonmajor Permanent Funds

June 30, 2006

	R.L. Owen	Cemetery	
	Memorial	Perpetual	Total
		Care	
<u>Assets</u>			
Cash and cash equivalents	\$ 14,018	\$ 100,456	\$ 114,474
Investments, at cost	-	443,628	443,628
Inventory	-	-	-
Prepaid expenditures	-	-	-
Total assets	<u>\$ 14,018</u>	<u>\$ 544,084</u>	<u>\$ 558,102</u>
<u>Liabilities and Fund Balances</u>			
Liabilities:			
Due to other agencies	\$ -	\$ -	\$ -
Fund Balances:			
Reserved for perpetual care and endowment principal	<u>14,018</u>	<u>544,084</u>	<u>558,102</u>
Total fund balances	<u>14,018</u>	<u>544,084</u>	<u>558,102</u>
Total liabilities and fund balances	<u>\$ 14,018</u>	<u>\$ 544,084</u>	<u>\$ 558,102</u>

City of Hillsdale, Michigan
Combining Statement of Revenues, Expenditures, and
Changes in Fund Balances
Nonmajor Permanent Funds
Year Ended June 30, 2006

	<u>R.L. Owen Memorial</u>	<u>Cemetery Perpetual Care</u>	<u>Total</u>
Revenues:			
Fees	\$ -	\$ 13,926	\$ 13,926
Investment income	<u>3,192</u>	<u>12,626</u>	<u>15,818</u>
Total revenues	<u>3,192</u>	<u>26,552</u>	<u>29,744</u>
Other Financing Uses:			
Operating transfers out	<u>(12,000)</u>	<u>(28,871)</u>	<u>(40,871)</u>
Changes in Fund Balances	(8,808)	(2,319)	(11,127)
Fund Balances - Beginning of Year	<u>22,826</u>	<u>546,403</u>	<u>569,229</u>
Fund Balances - End of Year	<u>\$ 14,018</u>	<u>\$ 544,084</u>	<u>\$ 558,102</u>

City of Hillsdale, Michigan
Comparative Statements of Revenues, Expenses,
and Changes in Net Assets
Dial-A-Ride Enterprise Fund
Years Ended June 30, 2006 and 2005

	<u>07/01/2005 -</u> <u>9/30/2005</u>	<u>10/01/2005 -</u> <u>6/30/2006</u>	<u>Total</u>	<u>2005</u>
Operating Revenues:				
Demand response (farebox)	\$ 12,358	\$ 46,645	\$ 59,003	\$ 49,977
Operating Expenses	<u>79,764</u>	<u>349,503</u>	<u>429,267</u>	<u>447,737</u>
Operating Loss	(67,406)	(302,858)	(370,264)	(397,760)
Nonoperating Revenues	<u>45,436</u>	<u>325,465</u>	<u>370,901</u>	<u>324,525</u>
Net Income (Loss)	<u>\$ (21,970)</u>	<u>\$ 22,607</u>	637	(73,235)
Net Assets - Beginning of Year			<u>127,486</u>	<u>200,721</u>
Net Assets - End of Year			<u>\$ 128,123</u>	<u>\$ 127,486</u>

City of Hillsdale, Michigan
Comparative Schedules of Operating Expenses
Dial-A-Ride Enterprise Fund
Years Ended June 30, 2006 and 2005

	<u>Operations</u>	<u>Maintenance</u>	<u>General</u>	<u>(1) 2006 Total System</u>	<u>(1) 2005 Total System</u>
Labor:					
Operator salaries and wages	\$ 203,404	\$ -	\$ -	\$ 203,404	\$ 215,983
Fringe Benefits	86,223	-	-	86,223	88,533
Services:					
Contractual	8,421	-	-	8,421	9,232
Telephone	-	-	1,439	1,439	1,522
Vehicle Maintenance	-	6,752	-	6,752	14,853
Materials and Supplies Consumed:					
Fuel and lubricants	26,615	-	-	26,615	21,286
Other materials and supplies	1,284	-	-	1,284	747
Casualty and Liability Costs:					
Premiums for public liability and property damage insurance	17,208	-	-	17,208	18,248
Miscellaneous Expenses:					
Other	5,127	-	-	5,127	4,157
Rentals	-	-	15,600	15,600	15,600
Depreciation	57,194	-	-	57,194	57,576
Total expenses	<u>\$ 405,476</u>	<u>\$ 6,752</u>	<u>\$ 17,039</u>	<u>\$ 429,267</u>	<u>\$ 447,737</u>

(1) All General Operations

City of Hillsdale, Michigan
Comparative Schedules of Non-Operating Revenues
Dial-A-Ride Enterprise Fund
For the Years Ended June 30, 2006 and 2005

	07/01/2005 - 9/30/2005	10/01/2005 - 6/30/2006	Total	2005
Non-Operating Revenues:				
Local - transfer from General Fund	\$ -	\$ 57,950	\$ 57,950	\$ 113,093
Other	-	-	-	5,906
Subtotal local	-	57,950	57,950	118,999
State of Michigan Grants				
Formula assistance (Act 51) - FY 99 Closeout	-	-	-	(8,316)
Formula assistance (Act 51) - FY 01 & 04 Closeout	(1,012)	(149)	(1,161)	-
Formula assistance (Act 51) - FY 03 Closeout	-	(1,763)	(1,763)	(1,331)
Formula assistance (Act 51) - FY 05 Budget reduction	(8,000)	-	(8,000)	42,892
Formula assistance (Act 51) - FY 05	42,376	-	42,376	127,134
Formula assistance (Act 51) - FY 06	-	141,579	141,579	-
Subtotal State of Michigan grants	33,364	139,667	173,031	160,379
Federal Grants:				
U.S.D.O.T. grant - Section 18/5311:				
Contract 2002-0044Z6	-	-	-	14,531
Contract 2002-0044Z1	-	-	-	2,544
Contract 2002-0044Z8	12,072	11,112	23,184	23,915
Contract 2002-0044Z9	-	43,326	43,326	-
RTAP Training	-	-	-	255
Subtotal U.S.D.O.T. grant - Section 18/5311	12,072	54,438	66,510	41,245
U.S.D.O.T. grant - Section 18/5309:				
Contract 2002-0044Z2	-	-	-	3,902
Contract 2002-0044Z7	-	73,410	73,410	-
Subtotal U.S.D.O.T. grant - Section 18/5309	-	73,410	73,410	3,902
Subtotal federal grants	12,072	127,848	139,920	45,147
Total non-operating revenues - local, state and federal	\$ 45,436	\$ 325,465	\$ 370,901	\$ 324,525

City of Hillsdale, Michigan
Net Eligible Costs Computations of General Operations
Dial-A-Ride Enterprise Fund
For the Year Ended June 30, 2006

	Federal Section 5311		State Operating Assistance	
	2002-0044Z6	2002-0044Z8		
	7/1/05 - 9/30/05	10/1/05 - 6/30/06	7/1/05 - 9/30/05	10/1/05 - 6/30/06
Expenses:				
Labor	\$ 32,156	\$ 171,248	\$ 32,156	\$ 171,248
Fringe benefits	22,279	63,944	22,279	63,944
Services	763	7,658	763	7,658
Utilities	204	1,235	204	1,235
Vehicle maintenance	2,527	4,225	2,527	4,225
Materials and supplies	3,175	24,724	3,175	24,724
Casualty and liability costs	-	17,208	-	17,208
Miscellaneous expense	462	4,664	462	4,664
Rental	3,900	11,700	3,900	11,700
Depreciation	14,298	42,896	14,298	42,896
Total expenses	79,764	349,502	79,764	349,502
Less Ineligible Expenses:				
RTAP training	-	-	-	-
5309 expense reimbursement	-	-	-	-
Depreciation	14,298	42,896	14,298	42,896
Total ineligible expenses	14,298	42,896	14,298	42,896
Net eligible expenses	65,466	306,606	65,466	306,606
Maximum Section 5311 Reimbursement				
Progress payments (10.95% and 12.18%)	\$ 23,184 (1)	\$ 43,326 (2)		
Eligible for State Operating:				
For 7/01/05 to 9/30/05			\$ 42,376 (3)	
For 10/01/05 to 6/30/06 (2)				\$ 141,579 (4)

(1) Received \$47,099 in progress payments to 6/30/06. Subject to adjustment on closeout.

(2) Received \$43,326 in progress payments to 6/30/06. Subject to adjustment on closeout.

(3) Represents three monthly progress payments. Total payments for 10/1/04 to 9/30/05 are \$169,510.

(4) There have been \$141,579 in payments through 6/30/06.

City of Hillsdale, Michigan
Comparative Schedules of Mileage Data (Unaudited)
Dial-A-Ride Enterprise Fund
Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Demand - Response:		
1st quarter	13,735	15,705
2nd quarter	17,048	18,915
3rd quarter	19,627	20,205
4th quarter	<u>15,857</u>	<u>18,110</u>
 Total operation mileage	 <u>66,267</u>	 <u>72,935</u>

The methodology used for compiling mileage has been reviewed and found to be an adequate and reliable method for recording vehicle mileage.

No miles are logged for charter operations, nor school bus mileage.

City of Hillsdale, Michigan
Combining Statement of Net Assets
Internal Service Funds
June 30, 2006

	Department of				
	Public Service	Public	Revolving	Unemployment	
	Leave &	Service	Mobile	Insurance	
	Benefits	Inventory	Equipment		Total
Assets:					
Current assets:					
Cash and cash equivalents	\$ 28,270	\$ 19,800	\$ 150,301	\$ 61,208	\$ 259,579
Inventory	-	142,589	-	-	142,589
Prepaid expenses	16,217	-	14,059	-	30,276
Total current assets	44,487	162,389	164,360	61,208	432,444
Capital assets:					
Equipment	-	-	1,584,712	-	1,584,712
Less: accumulated depreciation	-	-	(1,161,672)	-	(1,161,672)
Total capital assets, net	-	-	423,040	-	423,040
Total assets	44,487	162,389	587,400	61,208	855,484
Liabilities:					
Current liabilities:					
Accounts payable	-	10,237	28,291	-	38,528
Accrued payroll and related liabilities	-	-	454	-	454
Total current liabilities	-	10,237	28,745	-	38,982
Other liabilities:					
Compensated absences	36,918	-	9,154	-	46,072
Total liabilities	36,918	10,237	37,899	-	85,054
Net Assets:					
Invested in capital assets, net of related debt	-	-	423,040	-	423,040
Unrestricted	7,569	152,152	126,461	61,208	347,390
Total net assets	\$ 7,569	\$ 152,152	\$ 549,501	\$ 61,208	\$ 770,430

City of Hillsdale, Michigan
Combining Statement of Revenues, Expenses
and Changes in Net Assets
Internal Service Funds
Year Ended June 30, 2006

	Department of Public Service Leave & Benefits	Public Service Inventory	Revolving Mobile Equipment	Unemployment Insurance	Total
Operating Revenues:					
Charges for services	\$ -	\$ 97,271	\$ 360,225	\$ -	\$ 457,496
Other revenue	<u>150,767</u>	<u>-</u>	<u>2,752</u>	<u>5,400</u>	<u>158,919</u>
Total operating revenues	<u>150,767</u>	<u>97,271</u>	<u>362,977</u>	<u>5,400</u>	<u>616,415</u>
Operating Expenses:					
Salaries	150,767	601	38,647	-	190,015
Fringe benefits	-	44	18,870	-	18,914
Supplies	-	87,768	7,742	-	95,510
Services	-	-	30,841	-	30,841
Maintenance	-	-	122,032	-	122,032
Insurance	-	-	26,561	-	26,561
Miscellaneous	-	114	11,639	2,631	14,384
Capital outlay	-	-	2,322	-	2,322
Depreciation	<u>-</u>	<u>-</u>	<u>92,608</u>	<u>-</u>	<u>92,608</u>
Total operating expenses	<u>150,767</u>	<u>88,527</u>	<u>351,262</u>	<u>2,631</u>	<u>593,187</u>
Operating Income (Loss)	-	8,744	11,715	2,769	23,228
Nonoperating Revenues:					
Interest income	<u>-</u>	<u>-</u>	<u>8,146</u>	<u>2,332</u>	<u>10,478</u>
Changes in Net Assets	-	8,744	19,861	5,101	33,706
Net Assets - Beginning of Year	<u>7,569</u>	<u>143,408</u>	<u>529,640</u>	<u>56,107</u>	<u>736,724</u>
Net Assets - End of Year	<u>\$ 7,569</u>	<u>\$ 152,152</u>	<u>\$ 549,501</u>	<u>\$ 61,208</u>	<u>\$ 770,430</u>

City of Hillsdale, Michigan
Combining Statement of Cash Flows
Internal Service Funds
Year Ended June 30, 2006

	Department of Public Service Leave & Benefits	Public Service Inventory	Revolving Mobile Equipment	Unemployment Insurance	Total
Cash Flows From Operating Activities:					
Cash paid to employees and suppliers	\$ (147,221)	\$ (102,490)	\$ (240,291)	\$ (2,631)	\$ (492,633)
Receipts for interfund services provided	150,767	97,271	363,021	5,400	616,459
Net cash provided by (used in) operating activities	3,546	(5,219)	122,730	2,769	123,826
Cash Flows From Capital and Related Financing Activities:					
Purchase of capital assets	-	-	(116,643)	-	(116,643)
Cash Flows From Investing Activities:					
Interest income	-	-	8,146	2,332	10,478
Net Increase (Decrease) in Cash and Cash Equivalents	3,546	(5,219)	14,233	5,101	17,661
Cash and Cash Equivalents - Beginning of Year	24,724	25,019	136,068	56,107	241,918
Cash and Cash Equivalents - End of Year	\$ 28,270	\$ 19,800	\$ 150,301	\$ 61,208	\$ 259,579
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:					
Operating income (loss)	\$ -	\$ 8,744	\$ 11,715	\$ 2,769	\$ 23,228
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:					
Depreciation	-	-	92,608	-	92,608
Changes in:					
Accounts receivable	-	-	44	-	44
Inventory	-	(18,157)	-	-	(18,157)
Prepaid expenses	670	-	791	-	1,461
Accounts payable	(132)	4,194	17,593	-	21,655
Accrued expenses	3,008	-	(21)	-	2,987
Net Cash Provided by (Used in) Operating Activities	\$ 3,546	\$ (5,219)	\$ 122,730	\$ 2,769	\$ 123,826

City of Hillsdale, Michigan
Comparative Balance Sheets
Tax Increment Finance Authority Component Unit
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets:		
Cash and cash equivalents	\$ 214,925	\$ 116,291
Total assets	<u>\$ 214,925</u>	<u>\$ 116,291</u>
Fund Balances:		
Unreserved; undesignated	<u>\$ 214,925</u>	<u>\$ 116,291</u>

City of Hillsdale, Michigan
Statement of Revenues, Expenditures and Changes
in Fund Balances - Budget to Actual
Tax Increment Finance Authority - Component Unit
Year Ended June 30, 2006
(With Comparative Amounts for the Year Ended June 30, 2005)

	<u>2006</u>		<u>Variance -</u>	
	<u>Budget</u>	<u>Actual</u>	<u>(Unfavorable)</u>	<u>2005</u>
Revenues:				
Local sources:				
Property taxes	\$ 85,000	\$ 95,853	\$ 10,853	\$ 92,268
Earnings on investments	<u>500</u>	<u>7,457</u>	<u>6,957</u>	<u>1,125</u>
Total revenues	85,500	103,310	17,810	93,393
Expenditures:				
Capital outlay	<u>-</u>	<u>2,823</u>	<u>(2,823)</u>	<u>-</u>
Revenues Over (Under) Expenditures	<u>85,500</u>	<u>100,487</u>	<u>14,987</u>	<u>93,393</u>
Other Financing Sources (Uses):				
Operating transfers out	<u>(20,000)</u>	<u>(1,853)</u>	<u>18,147</u>	<u>(7,500)</u>
Total other financing sources (uses)	<u>(20,000)</u>	<u>(1,853)</u>	<u>18,147</u>	<u>(7,500)</u>
Net Changes in Fund Balances	65,500	98,634	33,134	85,893
Fund Balances - Beginning of Year	<u>116,291</u>	<u>116,291</u>	<u>-</u>	<u>30,398</u>
Fund Balances - End of Year	<u>\$ 181,791</u>	<u>\$ 214,925</u>	<u>\$ 33,134</u>	<u>\$ 116,291</u>

City of Hillsdale, Michigan
Comparative Balance Sheets
Economic Development Corporation Component Unit
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets:		
Cash and cash equivalents	\$ <u>102,127</u>	\$ <u>99,190</u>
Fund Balances		
Unreserved; undesignated	\$ <u>102,127</u>	\$ <u>99,190</u>

City of Hillsdale, Michigan
Statement of Revenues, Expenditures and Changes
in Fund Balances - Budget to Actual
Economic Development Corporation - Component Unit
Year Ended June 30, 2006
(With Comparative Amounts for the Year Ended June 30, 2005)

	<u>2006</u>			
	<u>Budget</u>	<u>Actual</u>	<u>Variance - Favorable (Unfavorable)</u>	<u>2005</u>
Revenues:				
Local sources:				
Other revenue	\$ 15,000	\$ -	\$ (15,000)	\$ -
Earnings on investments	500	3,552	3,052	720
Total revenues	15,500	3,552	(11,948)	720
Expenditures:				
Capital outlay	-	615	(615)	200
Revenues Over (Under) Expenditures	15,500	2,937	(12,563)	520
Other Financing Sources (Uses):				
Operating transfers in	-	-	-	62,500
Operating transfers out	(15,000)	-	15,000	-
Total other financing sources (uses)	(15,000)	-	15,000	62,500
Net Changes in Fund Balances	500	2,937	2,437	63,020
Fund Balances - Beginning of Year	99,190	99,190	-	36,170
Fund Balances - End of Year	<u>\$ 99,690</u>	<u>\$ 102,127</u>	<u>\$ 2,437</u>	<u>\$ 99,190</u>



August 31, 2006

Members of City Council
City of Hillsdale
Hillsdale, Michigan

We have audited the financial statements of the City of Hillsdale for the year ended June 30, 2006, and have issued our report thereon dated August 31, 2006.

Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or illegal acts may exist and not be detected by us.

As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the current year. We noted no transactions entered into by the City during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was the allowance for doubtful accounts with the Enterprise Funds.

WILLIS & JURASEK, P.C.

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City of Hillsdale
Hillsdale, Michigan

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City of Hillsdale
Comments and Recommendations
June 30, 2006

Budget to Actual Results

The City maintains and adopts an annual budget. During the year ended February 28, 2006 there were a few areas where actual expenditures exceeded final budgeted amounts. The budget should be monitored and amendments made as needed during the year. While the amounts were not significant, proper budgeting procedures should be followed and amendments made when required during the year.

Fixed Assets

We recommend you set up a separate mechanism for monitoring fixed assets during the year. Your current software package may handle this. At a minimum the schedule you keep should set up a summary page showing beginning of the year assets, then any additions and deletions. Accumulated depreciation should be set up in a similar manner. This would allow for easy monitoring of fixed assets during the year and at year end.

New Auditing Standards

10 new auditing standards were recently released and will become effective over the City's next two fiscal years. We do not believe, for the most part, that they will have a significant impact on our overall audit approach. However, two of the new standards will impact the City with next year's audit.

One of the new standards revises the dating of the auditor's report. Currently the last day of field work is the date of the audit report. Under the new standard, the audit report date is the date adequate audit evidence is obtained. Part of definition of adequate audit evidence includes the client's approval of draft financial statements. While this may not seem to have much impact to the City, it does affect an auditors' subsequent events work. Potentially if there is a long period of time needed to resolve open issues it could extend the dating of the audit report and the amount of work needed to complete subsequent events work.

The other new standard deals with communications between the auditor and client. The new standard added two new categories of deficiencies to include "significant deficiency" and control deficiency". Included in examples of strong indicators of significant deficiencies and possibly material weaknesses was the situation of the client being unable to write financial statements, including the footnotes, in accordance with generally accepted accounting principles. Since we have prepared the financial statements and footnotes for the City, we will have to evaluate the City's ability to produce appropriate financial statements and footnotes and, assess, if any control deficiencies exist.

Management's estimate of the allowance for doubtful accounts is based on historical revenues, historical loss levels, and an analysis of the collectibility of individual accounts. We evaluated the key factors and assumptions used to develop the allowance in determining that it is reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City's financial reporting process (that is, cause future financial statements to be materially misstated). There were no significant audit adjustments recorded at year-end.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

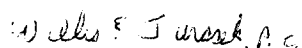
We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This information and the attached memorandum is intended solely for the use of the City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,



Willis & Jurasek, P.C.